

2022

INDIAN INSOLVENCY YEARLY REVIEW

TRINITY
CHAMBERS

Law Offices of Vasanth Rajasekaran

Published in **Live Law**

Indian Insolvency Yearly Review 2022

In recent years, several noteworthy judgments have been rendered by the Indian Courts in matters pertaining to the law of insolvency in India and in particular the Insolvency and Bankruptcy Code, 2016. This article covers ten such significant decisions rendered by the Supreme Court of India in the year 2022.

1. *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*

The power to admit a Section 7 application filed under the IBC is discretionary in nature. Therefore, it is not mandatory for the adjudicating authority to admit the Section 7 application even when there is the existence of debt and a default in payment.

In *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*¹, the Hon'ble Supreme Court rendered several crucial findings on the nature of the powers vested in an adjudicating authority under Section 7 of the Insolvency and Bankruptcy Code, 2016 ("IBC").

The Supreme Court observed that the adjudicating authority is vested with discretionary power under Section 7 of the IBC to accept or reject the financial creditor's application. If the facts and circumstances justify it, the adjudicating authority might suspend admission or even deny the application. If an application is denied, the financial creditor has the right to reapply for the commencement of CIRP if its dues remain unpaid.

On the exercise of discretion vested under Section 7, the Supreme Court held that ordinarily, the adjudicating authority must exercise its discretion to admit an application under Section 7 of the IBC and initiate CIRP upon satisfaction of the existence of a financial debt and default by the corporate debtor in payment of the debt. However, where there are good reasons not to admit the petition, the adjudicating authority can exercise its discretion to do so. Therefore, the adjudicating authority must consider the grounds made out by the corporate debtor against admission, on their own merits.

In the same case, the Supreme Court also made certain observations on the difference in the nature of financial and operational creditors under the scheme of the IBC. The Supreme Court observed that there is an inherent difference between financial creditors who are engaged in the business of investment and financing, and operational creditors who supply goods and services. It was opined that financial credit is often secured for a considerably long duration and intended to be used for the functioning of the corporate debtor. Thus, financial credit could not be compared to operational debts, which are typically unsecured, shorter in length, and of less value. In addition, it was observed that the financial strength of a financial creditor is usually better when compared with an operational creditor. Thus, the non-payment of admitted dues would have a far more significant impact on an operational creditor than on a financial creditor.

On the scheme of the IBC, the Supreme Court held that the IBC was designed to combine and amend laws in order to reorganise the corporate debtor and resolve insolvency in a timely fashion so as to maximise the value of the corporate debtor's assets. By initiating CIRP, the IBC does not intend to penalise solvent enterprises that temporarily defaulted on their financial obligations.

¹ *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*, (2022) 8 SCC 352.

2. *Asset Reconstruction Company (India) Ltd. v. Tulip Star Hotels Ltd.*

IBC is not a mere debt recovery law, it is aimed at reviving commercially ailing companies and resolving insolvency.

The entries in the books of account/ balance sheet of a company can be treated as an acknowledgement of debt.

The Supreme Court in *Asset Reconstruction Company (India) Ltd. v. Tulip Star Hotels Ltd.*² reiterated that the IBC is not just a statute for the recovery of debts or a legislation prescribing the liquidation procedures for a corporation that cannot pay its debts. On the contrary, the IBC is a beneficial legislation that essentially works towards the revival of a company by appointing a resolution professional and protecting the corporate debtor from a corporate death by liquidation.

On the aspect of acknowledgement of debts, the Supreme Court held that it is well settled that the entries in the books of account/balance sheet of a corporate can be treated as an acknowledgement of liability concerning debt payable to a financial creditor under Section 18 of the Limitation Act, 1963. Therefore, acknowledging liability in a company's balance sheet furnishes a fresh starting point for limitation.

Based on the above observations, the Supreme Court concluded that an application under Section 7 of the IBC would not be barred by limitation on the ground that it had been filed beyond a period of three years from the date of the corporate debtor's loan account getting declared as an NPA, if there were an acknowledgement of the debt by the corporate debtor before the expiry of the period of limitation of three years, in which case the period of limitation would get extended by a further period of three years.

3. *Sunil Kumar Jain v. Sundaresh Bhatt*

Only claims of workmen/ employees of a corporate debtor who were actually working while the corporate debtor was a going concern during CIRP would be provided first priority over all other dues under Section 53(1)(a) of the IBC.

In *Sunil Kumar Jain v. Sundaresh Bhatt*³, the Supreme Court held that while considering whether the claims of workmen/ employees of a corporate debtor are payable as CIRP costs, at the outset, it has to be established and proved that during the CIRP, the corporate debtor was a going concern and that the workmen/ employees concerned actually worked while the corporate debtor was a going concern. Only with respect to those workmen/ employees who actually worked during CIRP, would their wages/ salaries be included in the CIRP costs, and they shall be provided with the first priority over all other dues as per Section 53(1)(a) of the IBC.

The Supreme Court further clarified that wages and salaries of all other workmen/ employees of the corporate debtor during the CIRP who did not work when the corporate debtor was a going concern shall not be included automatically in the CIRP costs. Such dues shall be governed by Section 53(1)(b) and 53(1)(c) of the IBC.

² *Asset Reconstruction Company (India) Ltd. v. Tulip Star Hotels Ltd.*, 2022 SCC OnLine SC 944.

³ *Sunil Kumar Jain v. Sundaresh Bhatt*, (2022) 7 SCC 540.

4. *Kotak Mahindra Bank Ltd. v. A. Balakrishna*

A liability in respect of a claim arising out of a recovery certificate issued under Section 19(22) of the Recovery of Debts and Bankruptcy Act, 1993 would be a financial debt within the meaning of Section 5(8) of the IBC.

In *Kotak Mahindra Bank Ltd. v. A. Balakrishna*⁴, the Supreme Court observed that the liability in respect of a claim arising out of a recovery certificate granted under Section 19(22) of the Recovery of Debts and Bankruptcy Act, 1993, would be a financial debt within the ambit of the definition under Section 5(8) of the IBC. Therefore, as a natural corollary, the holder of a recovery certificate would be a financial creditor within the meaning of Section 5(7) of the IBC.

As per the Supreme Court, in line with the limitation period prescribed under the Limitation Act, 1963, the holder of the recovery certificate, being a financial creditor, would be entitled to initiate CIRP within a period of three years from the date on which the recovery certificate is issued. In this regard, the Supreme Court relied on the decision rendered in *Dena Bank (Now Bank of Baroda) v. C. Shivakumar Reddy*⁵.

5. *Consolidated Construction Consortium Ltd. v. Hitro Energy Solutions Pvt. Ltd.*

An advance payment made in lieu of goods or services would constitute operational debt under the scheme of the IBC.

In *Consolidated Construction Consortium Ltd. v. Hitro Energy Solutions Pvt. Ltd.*⁶, the Supreme Court rendered some important findings on what constitutes an operational debt and whether advance payments made for goods and services would constitute operational debt. It was observed that Section 5(21) of the IBC defined an operational debt as a claim in respect of the provision of goods or services. As per the Supreme Court, the operative requirement under Section 5(21) is that the claim must bear some nexus with a provision of goods or services, without specifying who is to be the supplier or receiver. It was held that the presence of an invoice for having supplied goods or services is not a *sine qua non*, since a demand notice could be issued based on other documents which prove the existence of a debt. As regards the words "*in respect of*" as appearing in Section 5(21) of the IBC, the Supreme Court observed that the same needed to be interpreted in a broad and purposive manner to include all those who provide or receive operational services from the corporate debtor, which ultimately lead to an operational debt.

Based on the above, on whether an advance payment made in lieu of goods or services would constitute an operational debt, the Supreme Court held that such amounts given in advance for goods and services would constitute an operational debt, and the payer of the advance amount in such cases shall be treated as the operational creditor.

⁴ *Kotak Mahindra Bank Ltd. v. A. Balakrishna*, (2022) 8 SCC 186.

⁵ *Dena Bank (Now Bank of Baroda) vs. C. Shivakumar Reddy*, (2021) 10 SCC 330.

⁶ *Consolidated Construction Consortium Ltd. v. Hitro Energy Solutions Pvt. Ltd.*, (2022) 7 SCC 164.

6. *Ashok G. Rajani v. Beacon Trusteeship Ltd.*

An adjudicating authority is empowered under Section 12A of the IBC to allow the withdrawal of an application admitted under Section 7 or Section 9, or Section 10.

In *Ashok G. Rajani v. Beacon Trusteeship Ltd.*⁷, the Supreme Court opined that Section 12 A of the IBC enables the adjudicating authority to allow the withdrawal of an application admitted under Section 7, Section 9, or Section 10 with prior approval of 90% voting shares of the Committee of Creditors ("**CoC**")

While addressing circumstances where the CoC had not been constituted yet, the Supreme Court opined that before the Committee of Creditors is constituted, there is no bar to withdrawal by the applicant of an application admitted under Section 7 IBC. In this regard, the Supreme Court referred to Rule 11 of the National Company Law Tribunal Rules, 2016 ("**NCLT Rules**"), which provides the adjudicating authority with the inherent powers to render such orders as it may deem necessary for meeting the ends of justice or prevent abuse of process.

The Supreme Court further noted that a settlement could not be impeded prior to the formation of the CoC in anticipation of third-party claims against the corporate debtor or given the urgency of timelines prescribed under the IBC. This is more so as the applicant's withdrawal of a CIRP application would not prohibit any other financial creditor from initiating a proceeding under the IBC.

7. *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*

The purpose of a moratorium, among other things, is to protect a corporate debtor's assets during the insolvency resolution process and to facilitate the orderly completion of the insolvency resolution process.

In *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*⁸, the Supreme Court discussed about the object and the effect of a moratorium declared under the IBC. The Supreme Court observed that one of the purposes of a moratorium is to keep the corporate debtor's assets together during the insolvency resolution process and to facilitate the orderly completion of the processes envisaged under the statute.

As per the Supreme Court, such measures ensure the curtailing of parallel proceedings and reduce the possibility of conflicting outcomes in the process. In this regard, the Supreme Court referred to the Report of the Insolvency Law Committee of February 2020, which stated that a moratorium is critical during the reorganisation proceedings since it facilitates the continued operation of the business and allows the debtor a breathing space to organise its affairs.

⁷ *Ashok G. Rajani v. Beacon Trusteeship Ltd.*, 2022 SCC OnLine SC 1275.

⁸ *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*, 2022 SCC OnLine SC 1101.

8. *Maitreya Doshi v. Anand Rathi Global Finance Ltd.*

If two companies are the borrowers and fall under the ambit of a corporate debtor, then both companies can be proceeded against by the creditors in insolvency proceedings.

In *Maitreya Doshi v. Anand Rathi Global Finance Ltd.*⁹, the moot question was whether insolvency proceedings could be initiated against two companies which fell within the ambit of a corporate debtor. The Supreme Court opined that if two corporate bodies were the borrowers and fell under the ambit of a corporate debtor, there was no reason why proceedings under Section 7 of the IBC could not be initiated against both the corporate debtors.

The Supreme Court further observed that if the dues are realised in part from one corporate debtor, only the balance could be realised from the other corporate debtor being the co-borrower. However, once the claim of the financial creditor is discharged, the question of recovering the claim twice does not arise.

9. *Amit Katyal v. Meera Ahuja*

Supreme Court allows homebuyers to withdraw the CIRP proceedings in terms of a settlement drawn amongst the concerned parties.

In *Amit Katyal v. Meera Ahuja*¹⁰, the Supreme Court was dealing with a matter in which a majority of the homebuyers were willing to have the Corporate Insolvency Resolution Process ("**CIRP**") set aside subject to the corporate debtor honouring its undertaking rendered in the form of a settlement plan.

The Supreme Court noted that since the settlement plan provided that a majority of the homebuyers were scheduled to have possession of their homes allotted in a span of one year, the matter was a fit case for the exercise of powers under Article 142 of the Constitution of India read with Rule 11 of the NCLT Rules to permit the original applicants in withdrawing the CIRP proceedings. The Supreme Court opined that this would be in the larger interest of the homebuyers who had been waiting for the possession of their homes for more than eight years. It was further observed that if the original applicants and the majority of the homebuyers were not permitted to close the CIRP proceedings, it would have a drastic consequence on the homebuyers of real estate projects. In this regard, the Supreme Court referred to the recent amendments made to the IBC and opined that the intent of the legislature was to secure, protect, and balance the interest of all homebuyers.

10. *State Tax Officer v. Rainbow Papers Ltd.*

A resolution plan which does not account for the dues payable to the government or any governmental authority is liable to be rejected by the adjudicating authority.

In *State Tax Officer v. Rainbow Papers Ltd.*¹¹, the Supreme Court opined that if a resolution plan does not account for the statutory demands payable to any state government or legal authority, the adjudicating authority is bound to reject the resolution plan. It was further

⁹ *Maitreya Doshi v. Anand Rathi Global Finance Ltd.*, 2022 SCC OnLine SC 1276.

¹⁰ *Amit Katyal v. Meera Ahuja*, (2022) 8 SCC 320.

¹¹ *State Tax Officer v. Rainbow Papers Ltd.*, 2022 SCC OnLine SC 1162

observed that if a company is unable to pay its debts, which should include its statutory dues to the government and/or other authorities and there is no plan which contemplates dissipation of those debts in a phased manner, uniform proportional reduction, the company would necessarily have to be liquidated and its assets sold and distributed as prescribed in Section 53 of the IBC. Lastly, the Supreme Court clarified that the CoC, which might include financial institutions and other financial creditors, cannot secure their own dues at the cost of statutory dues owed to the government or any other governmental authority or, for that matter, any other dues.

Authors:



Vasanth Rajasekaran



Harshvardhan Korada

Disclaimer: The document is purely an academic endeavor of the authors and does not constitute any professional advice or legal opinion. The contents of the document are intended to provide a general guide on the subject matter.