



# ASB

## INSOLVENCY TIMES



## Editorial



### Bad Banks in works to tackle Bad Loans from PSU Banks

The Centre is reportedly planning to constitute specialized Bad Banks to help state-controlled banks in getting rid of their toxic loans, leaving them to concentrate on core banking. A bad bank is an entity that purchases non-performing assets (NPAs) from banks at market price, clearing the balance sheet of lenders, and improving their fundraising capabilities. This is a significant and new contemporary mechanism for faster resolution through market-determined price discovery. The bad banks will collate bad debts across banks and reach out to institutional investors, including distressed funds for recovery and resolution.

### Authorities rushing towards Pre-Pack

Ministry of Corporate Affairs has come out with a scheme of Pre-packs and sought public comments. Pre-packaged Insolvency Resolution Process (PPIRP) may be introduced under IBC 2016, which will fasten the resolution process with the bulk of the discussions between debtors and creditors taking place out of court with court approval needed only for the agreed arrangement.

**Expect more vibrancy from the Insolvency Resolution Process.  
Stay Alert!**

**Anju Agarwal  
Partner  
ASC Insolvency Services LLP**



# News Flash

## **1. Applicability of Section 18 Limitation Act to proceedings under Insolvency & Bankruptcy Code: The Saga Ends**

Though the issue of applicability of Limitation Act on proceedings under the Code has been fairly well settled by a plethora of judgments of the Hon'ble Supreme Court, the issue of application of Section 18 of the Limitation Act has always remained a contentious issue before the courts, especially since this issue is usually dependent on the facts of a particular case and less on the issues of law.

Section 18 talks about the extension of the initial date for the period of limitation where a written and signed acknowledgment of liability has been issued by a party against whom a right or property is claimed. In the context of IBC, the question is whether such an acknowledgment of debt in entries in a balance sheet would extend the limitation period, to file an application for the initiation of the corporate insolvency resolution process (CIRP) under Section 7 of the IBC?

### **1.1 Is Balance Sheet an Acknowledgment of Liability Under Section 18 IBC**

In March, NCLAT's five-member bench held that the balance sheet/ annual return of a corporate debtor cannot be treated to be an acknowledgment under Section 18 of the Limitation Act.

### **1.2 The Impact of MM Ramachandran Judgment by the Supreme Court**

The said view of NCLAT regarding the extension of limitation by acknowledgment via balance sheet/annual return was challenged in the Supreme Court by MM Ramachandran. Wherein it was argued that Section 18 of the Limitation Act does not apply to proceedings under the Code at all. The Full Bench of the Supreme Court did not find merit in this argument.



## **2. Asset Reconstruction Companies as Resolution Applicants**

The inconsistency between the provisions of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 and those of the Insolvency and Bankruptcy Code 2016 regarding Asset Reconstruction Companies (ARCs) has come up recently when the Resolution Plan submitted by an ARC was rejected by the Reserve Bank of India for non-compliance to provisions regarding ARCs in the SARFAESI Act 2002.

Since the inception of IBC, over 250 companies have seen resolutions under IBC, out of which some of them have successfully been acquired by ARCs. SARFAESI Act says that ARCs cannot carry on any business other than that of asset reconstruction and/or securitization. Apart from these two, an ARC needs to take permission from the RBI to carry on any other business.

Notwithstanding the provisions of the SARFAESI Act, IBC has provisions for submission of the resolution plans by financial entities including an ARC. The question which arises here is, that if IBC allows financial creditors to submit a resolution plan, why can't ARCs, who are also categorized as financial creditors, do the same?

### **2.1 Creation and Purpose of ARCs under SARFAESI Act**

In accordance with the definition of "asset reconstruction company" U/s 2(1)(ba) of the SARFAESI Act, an ARC is created for the purposes of "asset reconstruction" or "reconstruction" or both."

A connected provision, section 15(4) of the SARFAESI Act which states that the secured creditor (in this case, an ARC) shall, on the full realization of debt, "restore the management of the business of the borrower to him". In the report, a thin line between 'realization' and 'rescue' was therefore drawn. Because the purpose and the aim of ARCs is to 'realize the dues' and reposition the creditor, in its truest sense, it does not amount to 'rescue'. However, by way of the Amendment Act, 2016, in the SARFAESI Act, a major change was introduced. Section 15(4) now provides that if any secured creditor has converted part of its debt into shares of a borrower company, together with other secured creditors or any asset rehabilitation company or financial institution or any other assignee and thus has gained a controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the borrower company's debt.'

### **2.2 ARCs as Resolution Applicants under The IBC**

Under IBC, Resolution applicants may be any person who submits a resolution proposal individually or jointly with any other individual. The person should not, however, be ineligible U/s 29A of IBC.

The second Proviso to clause (c) of Section 29A mentions that nothing in clause (c) applies to a resolution applicant where that applicant is a financial person and is not a related party to a Corporate Debtor. However, the relation does not include the person related to the Corporate Debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares or completion of such transactions.

The language of the statute, as set out above, makes it very clear that an ARC may be an applicant for a resolution under the IBC.



### **3. 264 Big Wilful Defaulters Owe Rs 1.08 Lakh Crore to Banks, Reveals RBI**

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As per our reports, in a reply to an application filed under the Right to Information (RTI) Act, 2005 the Reserve Bank of India (RBI) said that there are 1913 wilful defaulters, who together owed Rs1.46 lakh crore to banks as of June 2020. Mehul Choksi's scam-hit company, Gitanjali Gems Ltd, which owes Rs 5,747.05 crore was found to be leading the list, followed by REI Agro Ltd, with an amount of Rs 3,516 crore, and Frost International Ltd with an outstanding of Rs 3,097.64 crore.

Information provided by RBI does not reveal the names of the banks who had given these loans. However, data shared by the All India Bank Employees Association (AIBEA) shows that among the 17 public sector lenders, SBI has the highest number of wilful defaulters at 685, who together had defaulted on loans of Rs. 43,887 crore. It is followed by PNB, which has 325 wilful defaulters with an outstanding of Rs. 22,370 crore. The data shared by the bank employees' union, however, has no information about wilful defaulters in Union Bank of India (UBI) and IDBI Bank Ltd.

While the common borrowers are struggling with repaying equated monthly installments (EMIs) of their loans and also face harassment for missing a single EMI, big and wilful defaulters seem to not only go scot-free but also are calm without any worry or fear of any action due to the banks, especially the public sector banks (PSBs), turning a blind eye on these lapses.

### **4. IBC emerges as Major Mode of NPA Recovery**

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Non-performing assets (NPAs) recovered by scheduled commercial banks through the Insolvency and Bankruptcy Code (IBC) channel increased to about 61 percent of the total amount recovered. IBC, under which recovery is incidental to rescue of companies, remained the dominant mode of recovery, according to RBI's Report on Trend and Progress of Banking in India 2019-20.

SARFAESI ACT has also become the second most effective way to recover loans and NPA with financial institutions and Banks being the major lenders.

The Insolvency and Bankruptcy Code was primarily enacted to help banks recover a higher amount of bad loans than they had earlier. With its time-bound procedures, IBC has paved the way for a better and more efficient mode for the recovery of debts.



# JUDICIAL PRECEDENTS

## **1. M/s. Milkhi Ram Bhagwan Dass v. District Magistrate & Anr.**

### **On Violation of One Time Settlement by Borrower, Bank Free to Recover**

It has been held by the Punjab and Haryana High Court that once the terms and conditions of the One Time Settlement (OTS) entered with the bank are violated by a borrower and the settled amount is not paid within the agreed time frame, no further orders are required from the Court to extend the period of payment under the OTS. The Division Bench further held that in such a case, the Bank becomes free to recover the outstanding amount in accordance with the law, irrespective of the OTS.

In the instant case, the Court declined to apply another case wherein it was held that "claim for extension of time for payment of balance settlement amount, pursuant to mutually agreed on OTS by the borrowers should be considered by the Court, liberally." The Division Bench distinguished the present case from the Anu Bhalla case inasmuch as in that case extension of OTS was allowed after the defaulter had already repaid over 50% of the settled amount.

## **2. Rajnish Jain MD of suspended Board of Directors v. BVN Traders & Ors**

### **2.1 Resolution Professional cannot reclassify the status of a creditor from Financial to Operational Creditor?**

The IRP after collation of Claims and formation of 'Committee of Creditors' was not entitled to suo-motu review or change the status of a creditor from Financial to Operational Creditor. Updating list and review are different acts. If Resolution Professional was aggrieved, he should have moved the Adjudicating Authority. The aggrieved person can challenge either constitution of 'Committee of Creditors' or for any grievance against rejection, incorrect acceptance or categorisation of creditors before the Adjudicating Authority. But the Resolution Professional cannot arbitrarily on its own overturn earlier decision, to change the status of a creditor from Financial Creditor to Operational Creditor.

### **2.2 Committee of Creditors constituted under Section 21 of the Code, 2016, cannot determine that M/s BVN Traders' is a Financial or Operational Creditor?**

The NCLAT has observed that the 'Committee of Creditors' has no role in deciding the status of a creditor either as 'Financial' or 'Operational' Creditor and such a decision of 'Committee of Creditors' can never be treated as an exercise under its Commercial wisdom. It is a matter of applying the law of the I&B Code, and if such a factor is left to CoC, there would be a serious conflict of interest. Whether a person or entity is a "Financial Creditor" as defined in Section 5(7) or Operational Creditor as defined in Section 5(20) is a matter of applying the law to facts. It cannot be a matter of voting, and choice as discretion is not relevant. During the CIRP, the IRP collates the Claim, and after that, the 'Committee of Creditors' is formed under Section 18 of



the Code. After the formation of the 'Committee of Creditors', only the aggrieved person can agitate the same and that too, only before the Adjudicating Authority.

### **3. State Bank of India Vs. Leel Electricals Ltd.**

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#### **3.1 Decision Taken by CoC U/S 22 to Replace IRP is Absolute: Does Not Warrant Reasons: NCLAT**

The NCLAT, New Delhi has settled that the decision to substitute the Interim Resolution Professional by the Committee of Creditors under Section 22 of IBC is a commercial decision and the same is not required to be supported by any reasons whatsoever. The decision came in an appeal made against the order passed by the NCLT Allahabad bench permitting an opportunity to the Interim Resolution Professional (IRP) to file an affidavit in regard to the passing of a resolution by the Committee of Creditors (CoC) for its replacement by Resolution Professional (RP) under Section 22 of the IBC.

The Bench ordered that, "It is indisputable that these actions are permissible only within the ambit of S.22 of IBC. Therefore, invoking S.27 and adopting a protracted procedure in that regard, as appears to have been done by the Adjudicating Authority, is unwarranted. This only has resulted in wastage of time and prolonging the CIRP Process.

In the face of the CoC resolution, the company passed with more than the requisite majority, it cannot lie in the mouth of IRP that any of his legal rights have been infringed. It would have been wise on his part to bow to the commercial wisdom of the Committee of Creditors and quit gracefully. There was no merit in the case set up by IRP before the Adjudicating Authority and the same was required to be dealt with without insisting upon the filing of an affidavit by the IRP in regard to the provision of law invoked to pass the resolution.

### **4. Parole Hotels Pvt. Ltd. v. The Greater Bombay Cooperative Bank Ltd & Ors.**

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NCLAT has held that it is a settled position of law that the decision in regard to approval of the Committee of Creditors being a business decision based on commercial wisdom of the creditors is not open to judicial review by the Court. The order of approval of the Resolution Plan was assailed by the Ex-Director of the Corporate Debtor alleging that the Resolution Plan was passed after the connivance between the Resolution Professional and the Financial Creditor. He claimed that it was prepared with the apparent aim to only repay the outstanding dues.

NCLAT observed that there is ample proof on record to demonstrate that the Adjudicating Authority was approached at the time when the Corporate Insolvency Resolution Process was at an advanced stage and it had permitted the Appellant to take immediate steps for the settlement of the claim of the Financial Creditor. The Resolution Plan came to be approved more than three months thereafter. NCLAT observed that no grounds across the ambit of Section 61(3) of IBC demonstrating any material irregularity in the Corporate Insolvency Resolution Process are made out for interference.



## **5. Sh. Rajendra Nirottamdas Seth & Anr v. Chandra Prakash Jain & Anr**

In the instant case , the Appellant who was an Ex-Director filed an appeal against an order by the Adjudicating Authority on the application filed by Financial Creditor under Section 7. The Appellant relied on a judgment by the NCLAT wherein it was held that the payments made after the declaration of NPA would not give benefit of Section 19 of the Limitation Act, 1963 if the NPA had not been regularized by the Bank and the date of default remains to be the date of declaring NPAs.

NCLAT clarified that the limitation issue is decided on facts and law both and it may differ from case to case. Section 19 of the Limitation Act, 1963 is not subject to any such exception that after an account is declared NPA, if the debtor makes payments on account of debt, the Section would not be applicable. The Adjudicating Authority found that there were not merely repayments but also Acknowledgments. The NCLAT did not find any error in the observations by the Adjudicating Authority and held that the Application was within limitation. Accordingly, the appeal lacking any substance was dismissed.





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### **Delhi Head Office**

73, National Park, Lajpat Nagar IV,  
New Delhi - 110024 (India)  
Phone: +91-11-41729056-57, 41601289  
[www.ascgroup.in](http://www.ascgroup.in), [info@ascgroup.in](mailto:info@ascgroup.in)

### **Noida Corporate Office**

C-100, Sector-2, Noida- 201301  
Uttar Pradesh (India)  
Phone No: +91-120-4729400

### **Gurgaon Office**

605, Suncity Business Tower  
Golf Course Road, Sector-54,  
Gurugram - 122002, Haryana (India)  
Phone No.: +91-124-4245110/116

### **Mumbai Office**

Sagartech Plaza,  
B- Wing, Office No. 605,  
Andheri Kurla Road,  
Sakinaka, Andheri (East),  
Mumbai – 400 072, Maharashtra (India)  
Phone No: 022-67413369/70/71

### **Bengaluru Office**

0420, Second Floor,  
20th Main, 6th Block, Koramangala,  
Bangalore - 560095, Karnataka (India)  
Phone No.: 80-42139271

### **Chennai Office**

Level2 – 78/132,  
Dr RK Salai Mylapore  
Chennai - 600004, Tamil Nadu (India)  
Mobile No: +91-8860774980

### **Singapore Office**

11 Woodlands Close, #04-36 H,  
Woodlands 11, Singapore -737853  
Mobile No: +65-31632191  
[www.ascgroup.sg](http://www.ascgroup.sg),  
[info@ascgroup.sg](mailto:info@ascgroup.sg)

### **Canada Office**

885 Progress Ave Toronto  
Ontario M1H 3G3 Canada  
Mobile No: +1437-774-4488  
[www.ascventures.ca](http://www.ascventures.ca),  
[info@ascventures.ca](mailto:info@ascventures.ca)

Please write us at: [anju@insolvencyservices.in](mailto:anju@insolvencyservices.in), [mahima@insolvencyservices.in](mailto:mahima@insolvencyservices.in)

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