



ASC

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NSOLVENT?





From the Editor's Desk



Dear Insolvency Professionals,

Supreme Court reiterates that Corporate Debtor cannot raise dispute after committee of creditors approve resolution plan

In case of *Karad Urban Cooperative Bank Ltd vs Swwapnil Bhingardevay and Others*, the court accepted the application u/s 7 of the IBC Code. Following the due order of NCLT and the procedure prescribed under IBC Code, the Committee of Creditors had approved the resolution plan. At this stage, the Director/Promoter of the Corporate Debtor Company sought permission of NCLT to file a resolution plan under Section 10 of the Code. But the NCLT dismissed the Section 10 Application of the Corporate Debtor and approved the Resolution Plan submitted by the Resolution Applicant. After appeals, the matter went to Supreme Court and it reiterated that:

1. If any decision by CoC for commercial feasibility and viability has been taken, adjudicating authority has no power to interfere;
2. The Corporate Debtor can raise the issue of viability and feasibility of the Resolution Plan only in certain circumstances, i.e. if the Resolution Plan did not take care of certain relevant facts about the Company pending at other front or any such contingency.

Expect more vibrancy from Insolvency Resolution Process.

Stay Alert!

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NEWS FLASH FROM THE LAST MONTH

NCLAT sets aside insolvency proceedings against Sarda Agro Oils

NCLAT set aside Insolvency proceeding of Sarda Agro Oils by stating reason that the claims were filed three years after declaring the account non- performing asset. This 3 judge- bench gave the ruling that, “the date of default is computed from the date of declaration of account as a NPA (Non-Performing Asset) and such date of default would not shift. This is very important to be considered for the purpose of calculation of limitation period of 3 years as prescribed by the Limitation Act 1963. It will be impermissible to proceed with section 7 ie. Application filed by the financial creditor, in case the limitation period lapses.

In the given case, it was observed by NCLAT that due to irregular payments bank had declared this account as NPA on 30th September 2015, whereas the section 7 application was filed on 31st December 2018. Appellate Authority ordered NCLT to close this proceedings and declare all activities by resolution professional in the given case to be “Illegal”. "Consequently, orders passed by the Adjudicating Authority appointing IRP/ RP, declaring moratorium, freezing of account etc. and all consequential action taken by IRP/ RP including advertisement publication etc. all such orders and actions are declared illegal and set aside," the NCLAT said.

The bench gives emphasis to the relation of ‘date of Default’ to the ‘date of declaration of NPA’ to be same in such cases. According to the NCLAT, the Supreme Court has also held that the limitation period for application under Section 7 of the IBC is three years as provided by the Limitation Act, 1963 and is extendable only by the application of Section 5 of Limitation Act, 1963 if any case for condonation of delay is made out. Section 5 pertains to extension of the stipulated period.



The NCLAT set aside the insolvency proceedings against Ansal Properties and Infrastructure Ltd

The petition was filed by the two flat buyers who had jointly booked a unit in APIL Sushant Golf City Lucknow and one of them has also booked separate unit in same project, against the Ansal Properties and Infrastructure Ltd (APIL),

In the said petition It admitted the insolvency plea against APIL based on the recovery certificate which was issued by the Uttar Pradesh Real Estate regulatory Authority (UP RERA) because as per the agreement between them, the APIL undertook to complete it within two years from the date of commencement of construction on receipt of sanction plan from the authority and give them the possession within 2 years but he failed to do so.

NCLT gave its judgment on 17th march to initiate the resolution process and appointed an interim resolution professional replacing the board of the company.

When the petition was filed by Sushil Ansal, a director and shareholder of the company who challenged the NCLT order, the three member NCLAT bench gave its judgment that-

- 1) Order given by the NCLT to be set aside
- 2) The management of the company to be handed back to its board.

The NCLAT has observed that a decree-holder cannot be treated as a financial creditor for the purpose of triggering insolvency proceedings against a company. It states that NCLT should not admit the application of home buyers who claim to be financial creditors but as a decree holder on account of non-payment of the amount due under the recovery certificate issued by UP RERA.

Although it has been said that the decree holder is covered by the definition of creditor under S.3 (10) of the IBC but such entity would not fall in the definition of financial creditor unless the debt was disbursed against the consideration for the time value of money or falls within any of the clauses in the definition of financial debt.



SOME INSIGHTS AND FOOD FOR THOUGHT

To Enforce or to Relinquish: The issue of Joint Charge Holders under IBC

In a recent decision of the National Company Law Appellate Tribunal (NCLAT) in *Mr. Srikanth Dwarkanath, Liquidator of Surana Power Ltd. v. Bharat Heavy Electricals Ltd.*, the tribunal applied provisions of Securitization & Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act) to resolve the deadlock within Section 52 of the Insolvency & Bankruptcy Code (IBC).

Concept of charge & joint charge holders

A charge means an interest or lien created on the property of a company for securing the repayment of a debt. They are governed by private contracts between a lender & a borrower. Depending on the inter-creditor arrangement with the borrower, some contracts allow the creation of several charges on the same asset, while some do not. When several charges are created, the parties can either consent to creation of pari-passu charges. A pari-passu charge means when more than one creditor has a charge on the same property though created at different times.

The aspect of priority in charge holding becomes significant at the time of default as the priority in charge decides the distribution from the sale proceeds of an asset; the first charge holder is paid-off first, then the second-ranking charge holder, & so on. Pari-passu charge holders are equally placed & thus receive the proceeds in proportion to their debt. The enforcement of security interest takes place through Section 13 of the SARFAESI Act, however, when the company is in liquidation, there exists a parallel security enforcement mechanism under Section 52 of the IBC, read with Regulation 37 of Liquidation Process Regulations, 2016.

At the stage of liquidation, in accordance with Section 36 of the IBC, the liquidator forms a liquidation estate of all the assets of the corporate debtor. Since the secured creditors have an enforceable security interest on such assets, they have, under Section 52 of the IBC, a choice between relinquishing their security interest to the liquidation estate and realizing their security interest. Two kinds of situations arose, in making of this choice, which required judicial intervention:

1. Where all the secured creditors holding charges of *different ranking* on the *same asset* opted for treating the asset differently i.e. some creditors wanted to enforce their security interest independently



standing out of the liquidation pool; whereas the rest wanted to relinquish their interest to the liquidation pool.

2. Where all the secured creditors holding *pari-passu charges* on the same asset did not collectively opt for treating the asset similarly.

The tribunal addressed the first situation in *JM Financial Asset Reconstruction Company Limited v. Finquest Financial Solutions Private Limited*, holding that only the first charge-holder i.e. the secured creditor being highest in the inter-creditor ranking, is entitled to enforce his right for the realization of its debt out of the secured asset and no other 'secured creditor' can enforce his right subsequently for the realization of the amount for the same secured asset. In case the proceeds from realization are higher than the debt owed to the highest creditor, the extra amount would be transferred to the liquidation pool.

Facts

The Respondent i.e. Bharat Heavy Electricals Limited, an operational creditor, had succeeded in an arbitration proceeding against the corporate debtor, Surana Power and as part of the award, received a *pari-passu* charge i.e. a lien over the assets of the corporate debtor. The same assets were already hypothecated to ten other secured creditors.

Post the failure of the insolvency resolution process of the corporate debtor, the appellant was appointed as a liquidator. On commencement of the liquidation process, the respondent informed about its unwillingness to relinquish its security interest in the asset. On the other hand, the rest of the secured creditors had already relinquished their security interest into the liquidation estate of the corporate debtor.

Consequently, a deadlock had been created, wherein a part of the *pari-passu* charge holders had relinquished their interest and the other part wanted to enforce it. In these circumstances, the liquidator filed an application seeking permission from the Adjudicating Authority to sell the assets of the corporate debtor. The application was rejected by the Adjudicating Authority, and against that order, this appeal was preferred.

Setting aside the impugned order, the NCLAT held that all the secured creditors including the respondent are on the same footing regardless of the mode of the creation of charge. Furthermore, for equally-footed charge holders, it held that as per Section 13(9) of the SARFAESI Act, 2002 any steps



about the realization of assets by the secured creditors require confirmation from creditors holding at least 60% of the value of the total debt. Since the respondent held only 26.24% share (in value) of the total debt, it had no option but to relinquish its interest.

Analysis

It is contended that the tribunal's reasoning to debar the respondent's claim has two errors – first, that it fails to consider Regulation 37 as a parallel security enforcement mechanism; and second, that the application of Section 13(9) to the respondent's claim is erroneous.

Interest enforcement through Regulation 37

The tribunal reasoned that every enforcement of security interest takes place through Section 13 of the SARFAESI Act and because the respondent is a secured creditor, enforcement of its interest also had to take place through Section 13. The tribunal completely missed out on Regulation 37 of the Liquidation Process Regulations 2016, which gives the charge holders an option to enforce their interest through the code itself without availing the SARFAESI Act. This choice was correctly highlighted by the NCLT, Mumbai in **Edelweiss Asset Reconstruction Company Limited v Abhijeet MADC Nagpur Energy Private Limited**, wherein it had held:

"For realisation of the security interest, law provides two provisions. First option is to deal with the security interest in accordance with the provisions of Section 13 of SARFAESI Act 2002. Other option available to the secured creditor is provided under IBBBI (Liquidation Process) Regulations 2016, Regulation 37."

The tribunal failed to take note of a situation where a *pari-passu* charge holder, with any percentage of share in the security, can enforce its security interest through this regulation. There is nothing in the regulation which prevents any *pari-passu* charge holder from enforcing its interest through the code itself.

Section 13(9) and secured operational creditors

Another problem with the tribunal's reasoning is that it considers Section 13(9) of the SARFAESI Act to also apply to operational creditors, in addition to financial creditors. This, however, is incorrect as Section 13(9) is a bar on the enforcement rights granted under Section 13(4) and these enforcement rights are conferred only upon 'secured creditors.' 'Secured creditors' under the SARFAESI Act,



include only banks, financial institutions, asset reconstruction companies, and debenture trustees as per Section 2(zd), but does not include operational creditors. The respondent is an operational creditor and hence, the tribunal's reasoning to restrict the respondent's right based on Section 13(9) is erroneous.

Post-Resolution Determination of Claims: A Dilemma for Creditor's Rights

Given, the limitations of the Insolvency and Bankruptcy Code, 2016 ("IBC") in determining the value of disputed claims during the resolution process, most resolution plans admit the disputed claims with their repayment being dependent on the adjudication of the claim post the approval of the resolution plan. Such an admission of claims has been seen as a method to improve insolvency procedure by enabling time-bound resolution, but such a method raises certain problems in the Indian context. This article analyses the current framework of post-resolution adjudication of disputed claims while also highlighting the problems and proposing solutions to address the same.

The National Company Law Appellate Tribunal ("NCLAT") in *Standard Chartered Bank v. Satish Kumar Gupta* had upheld a direction by the adjudicating authority to admit disputed claims in total. However, the Supreme Court in *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta* reversed the order of the NCLAT by directing that disputed claims be admitted at 1 INR with the payment of the claim dependent on the outcome of the adjudication of the claim rather than the admission of claims in their entirety. Thus, the Supreme Court in *Essar Steel* carved out an adjudication mechanism for disputed claims by allowing them to be admitted and to be paid after the value of the claim has been determined by adjudication.

However, in cases such as *Tata Steel BSL Ltd. v. Varsha w/o Ajay Maheshwari*, the Bombay High Court observed that the adjudicating authority had approved a resolution plan which earmarked a fixed amount to satisfy disputed claims that has been notionally admitted. The Court held that when a resolution plan has earmarked an amount for the satisfaction of such claims, the creditor's claim would only be satisfied from the earmarked amount. In *Office of the Specified Officer v. Mr. V. Venkatachalam*, the NCLAT, held that it is within the commercial wisdom of the committee of creditors to set apart a certain amount to satisfy an unliquidated claim which would arise after the completion of the resolution process. In these cases, while the adjudication of claims after the approval of the resolution plan is continued, there is an upper limit to the amount available for the repayment of claims even before the value of the claim has been determined, thus giving rise to issues such as the denial of inter-se equality and minimum liquidation value to the creditors.



Violation of Inter-Se Equality among Creditors

The earmarking of fixed amounts for the payment of disputed debts upon their adjudication may result in operational creditors with disputed debts receiving payment to a lesser extent than other operational creditors. This is especially problematic since the NCLAT in *Central Bank of India v. Resolution Professional of the Sirpur Paper Mills Ltd.* had held that a resolution plan could not discriminate among similarly situated classes of creditors. In *Binani Industries Limited v. Bank of Baroda*, wherein, the NCLAT relied on the principles of value maximization of assets and balancing the interests of all stakeholders to hold that a resolution plan providing for inter-se unequal treatment of creditors is discriminatory and would not be approved under Section 31 of the IBC regarding the approval of a Resolution Plan.

In cases where disputed claims of operational creditors have to be paid from an earmarked amount, there may be inter-se inequality among creditors since other creditors would have been paid a certain percentage of their claims, while disputed claims would be paid from the earmarked amount rather than being paid as a percentage. For example, in a situation where the operational creditors have been fully paid, disputed claims by being limited to an earmarked amount may not be fully paid back as the value of the claim after adjudication not contemplated in calculating the earmarked amount.

Payment of Lower amount than Liquidation Value

Section 30(2) of the IBC provides that a resolution plan must provide for a minimum payment of the liquidation value to the operational creditors. The Supreme Court in *Maharashtra Seamless Limited v. Padmanabhan Venkatesh* interpreted Section 30(2) to mean that operational creditors may be paid a lower amount than the liquidation value if the financial creditors and the operational creditors have received the same percentage of their claim. However, as per the Supreme Court's judgment in *Essar Steel*, in cases where there is a difference in the percentage of the claim received by the financial creditors and the operational creditors, then the operational creditors would be entitled to receive at least the liquidation value.

The Adjudicating Authority would ensure that the earmarked amount under a resolution plan is enough to provide for the payment of liquidation value to the creditors based upon the valuation of their claims. The final determination of the value of the claims may lead to situations where the earmarked amount is insufficient to provide for the payment of the liquidation value to creditors with disputed claims. In such a situation, the protection available to the operational creditors under Section 30(2) would be rendered meaningless.



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