The Insolvency and Bankruptcy Code: The journey so far

The Insolvency and Bankruptcy Code has now been in force for more than a year and given its ambitious objectives and impact, it continues to make front-page news. Here, we examine three important themes that are developing in relation to the code, and look at the directions that the law may take on these fronts.

The interaction between insolvency law and other laws

As is the case with other laws relating to debt resolution, such as SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act) and the now repealed SICA (Sick Industrial Companies (Special Provisions) Act) the code contains a critical clause in Section 238, which lets it override other laws. This overriding effect of the code was tested in the Innoventive Industries case, a landmark decision of the Supreme Court. The apex court held that the code is an “exhaustive code” on the subject matter of corporate insolvency; this will be a relevant factor in the many subsequent conflicts with other laws that are bound to be raised.

One peculiar aspect of the code is that the National Company Law Tribunal (NCLT) cannot approve a resolution plan unless it is satisfied that the plan is fully compliant with existing laws (so it is not clear how this is supposed to tie in with the overriding nature of the code).

For example, in the Synergies Dooray case, the first resolution plan approved under the code, the plan included an amalgamation proposal and a request for certain tax reliefs. Now, the NCLT approved the plan, expressly dispensing with the requirement of procuring shareholder and creditor approvals for the amalgamation from both the company in insolvency as well as the healthy company with which the insolvent company was being merged. The NCLT appears to have extended the reach of Section 238 to even healthy companies so long as they are involved in a resolution plan. The Synergies resolution plan has been challenged before the appellate authority and this is likely to be one of the grounds of appeal. There are numerous areas where the interplay of laws could play a crucial role in the revival of the distressed company. For example, in:

Equity reduction: Most distressed companies will require this in some form or the other. Under the Companies Act, this will require consent of all creditors or shareholders/. If the Companies Act were to apply, this will obviate the 75% creditor threshold to pass a resolution under the code.

Tax reliefs: Presently under tax laws, debt write-offs invite significant tax liability for the distressed company. Relief from this will be key for any successful revival.

Debt to equity conversions: Many present distressed companies are contemplating a debt to equity conversion. This requires procedural compliance under the Companies Act, many of whose provisions are duplicative of the code, for e.g., procuring yet another valuation report.

Delisting: The code recognizes shareholders as being last in the payment waterfall for a distressed company. The present delisting regulations recognize that a distressed company can be delisted if so ordered under the erstwhile SICA regime. There is no such exemption for the code. It would indeed be odd where creditors (including trade creditors, workmen and employees) are all taking a haircut on their dues while shareholders get to enjoy an upside when the distressed company revives under a new management.

These are all reasons why the code needs to be considered as “exhaustive” and the NCLT, as the adjudicating authority, a “single window clearance”. The law and NCLT judgments will need to move in this direction.

Creditor classes under the code and the position of other stakeholders

A fundamental feature of insolvency law is creditor protection, which involves altering the relationship between a company and its creditors.

In this respect, the code divides creditors into two classes, financial and operational, and provides superior rights to financial creditors to control the appointment of the resolution professional and choose the resolution plan. Both classes, however, can trigger the insolvency resolution process. Recent developments, however, indicate that we may need to re-examine the concepts of financial and operational creditors (a bit sooner than anticipated).

In the Nikhil Mehta and Sons vs AMR Infrastructure case—one of the earliest cases of homeowners versus real estate companies—the NCLAT treated homebuyers as financial creditors because the real estate developer had promised an “assured return” for the homebuyers contributing to the financing of their projects. While the assured return element likely satisfies the code’s definition of financial debt (which is based on the “time value of money”) it is difficult to argue that homebuyers are capable of judging the commercial viability of a real estate company (a distinguishing factor for financial creditors, according to the legislative notes to the Insolvency and Bankruptcy Bill).

Then, there is the Jaypee Infratech Ltd case which involves more than 50,000 homebuyers. There, we have seen the Insolvency and Bankruptcy Board of India (IBBI) allow homebuyers to file their claims with the resolution professional and the Supreme Court direct the company’s promoter to make a significant security deposit and allow the participation of two homebuyer representatives in the insolvency proceedings. This has also prompted a discussion on whether the law needs to be amended to give special treatment to certain classes of creditors such as homebuyers.

Financial and operational creditors are the key constituencies under the code, so there must be urgent efforts to resolve any ambiguities in the definitions. At the same time, ad hoc regulatory or judicial interventions in the operation of the code, although well-intentioned, must be avoided and efforts should be made for reasoned policy-based solutions.

Judicial power and procedure

Both the NCLT and National Company Law Appellate Tribunal (NCLAT) have a very specific adjudicatory role under the code and there are limited grounds of challenge and appeal. At the same time, both tribunals generally also apply principles of “natural justice”, an idea that usually relates to procedural unfairness but can, depending on circumstances, extend to substantial relief as well. This is obviously a delicate balancing act.

We do not wish to have an overtly intrusive judiciary affecting the insolvency resolution which is really a dialogue between debtors and creditors. But equally, we do need the judiciary to have some inherent powers to iron out flaws under the code. In this context, the following cases are interesting:

In the J.K. Jute Mills case, the NCLAT ruled that the 14-day timeline for the NCLT to decide on an application’s admissibility is only “directory” and not “mandatory”. This ruling appears to be based on a tacit recognition of the NCLT’s inherent powers to decide in the interest of fairness and justice.

On the other hand, in the Lokhandwala Kataria case, the NCLAT refused to find an inherent power of the NCLT to allow a creditor to withdraw its application, once the application was admitted. On appeal, the Supreme Court on a summary hearing basis agreed with the NCLAT's reasoning regarding inherent powers but nevertheless allowed the company and its creditor to settle, exercising its own inherent powers under Article 142 of the Constitution of India. Post-admission settlements are not in line with the scheme or spirit of the code and, hopefully, this case is not treated as a precedent (though there have been a few others as well).

In the short period of time that the insolvency code has been in force, both the NCLT and the NCLAT have adapted admirably to new legal concepts and strict procedural timelines. This must continue, of course, as an efficient judicial process is also critical in protecting the going concern value of distressed companies.

Till now the story of the code has been about its invocation. This now turns to whether the code really revives distressed companies. In order to be an effective tool of revival, the new government committee set up to review the code will surely be considering some of these points raised above.

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