

Triggering the Corporate Insolvency Resolution Process by the Operational Creditor Under Insolvency and Bankruptcy Code 2016

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Abstract

Need of a comprehensive Insolvency and bankruptcy law was highlighted by the Law Commission Report in the year 1964. Unanimously The Insolvency and Bankruptcy Code 2016 is one of the biggest economic reform India has witnessed in recent times. The Code is to help establishments in financial distress and also to ensure repayment of debt in timely manner, therefore it is beneficial for debtor as well as creditor. The Code has made substantive changes in eleven enactments and repeal few to avoid any conflicting situation. It has established Insolvency and Bankruptcy Board, which has been issuing notifications for framing rules and regulations for the functioning of this Code. Country cannot attract investment without giving easy and comprehensive exit option. Due to paucity of time and limitation of pages, it was not possible to make a comparative study. Therefore, the discussion is in the light of I & B Code 2016, in which there is complete mechanism to trigger the insolvency by stakeholders like corporate creditor, operational creditor, etc. This paper is confined on the initiation of the corporate insolvency resolution process by the operational creditor. In this paper, the attempt was to understand the statutory provision and also application of the same by adjudicatory authority, i.e., National Company Law Tribunal. It is also interesting to see how the appellate authority, i.e., National Company Law Appellate Tribunal is interpreting the Code. Paper has also touched upon the latest Supreme Court judgement, which gives a perspective of interpretation where the statutes with economic impact are in question.

“In the last few decades, interplay between law and economics has gained momentum throughout the world. Indian judiciary has resorted to economic analysis of law on ad hoc basis. Time has come to consider the inter-discipline between law and economics as a profound movement on sustainable basis.”

-Justice A. K. Sikri²

I. Moving towards Ease of Doing Business:

The laws related to insolvency and bankruptcy under one umbrella was much needed for our industry. It was recommended by all committees and reports who has worked upon issue of ease of doing business in India. The recent one is the report of the Viswanathan Committee³ that gave model Code of Insolvency and Bankruptcy Code, 2015. It was recommended by the aforesaid committee that the process regarding bankruptcy must be strengthened and ensure a robust legal framework. The Committee recommended that once the bankruptcy process has started, it should be established as irreversible as quickly as possible, and be concluded in as short a time as is reasonably possible.

II. Arrival of the Much Awaited Code in 2016:

The Insolvency and Bankruptcy Code 2016 (hereafter I & B Code 2016) has arrived as fresh breeze for the companies in financial difficulties, who could be vulnerable and prone to be

attacked by creditors but it has also come as saviour for employees who are first one to get affected by financial difficulty in any establishment.⁴ Countries like Germany have made provision that failure to file for insolvency even though the Company is insolvent and the director is aware of this fact, constitute a criminal offence although Indian law rightly differ on this point as we are developing economy and we need little more time before we proceed to stringent laws for the industry.

Principles behind having law related to insolvency and bankruptcy are same in every jurisdiction although procedures and concluding steps vary in different legal setups. The procedure and insolvency plan in I & B Code 2016 resembles to Chapter 11 of the United States Bankruptcy Code but there are number of differences which are necessary to suit I & B Code to the Indian business environment.⁵

III. Initiation of the Process

If any debtor who falls under scope of I & B Code 2016, commits a default in payment then a financial creditor, an operational creditor or the corporate debtor itself can initiate the corporate insolvency resolution process. The procedure for the initiation by operational creditor differs from other creditors. Operational creditor is expected to give the demand notice of unpaid operational debt and if he does not receive payment within ten days of the service of the notice to the debtor then he can file the application⁶. The term "demand notice" is explained in Section 9 of the Code, which means a "demand notice" served by an operational creditor to the corporate debtor demanding repayment of the operational debt in respect of which the default has occurred. Here default means non-payment of debt which has become payable and is not repaid by the debtor.⁷ Since the definition refer debt we must know that the debt means a liability in respect of a claim which is due from any person and includes an operational debt.⁸ Therefore, for initiation of the process there has to be a claim which means there shall be "right to payment".⁹

After the expiry of the period of ten days from the date of delivery of the demand notice or invoice demanding payment under section 8(1), if the operational creditor does not receive payment from the corporate debtor or notice of the dispute under section 8(2), the operational creditor may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process under Section 9 of the Code.¹⁰

IV. Meaning of "Dispute" and "existence of a dispute"

When application from the operational creditor is received by the Adjudicating Authority, it has to be examined that whether notice of dispute in fact raises the dispute within the parameters of the 'debt' and 'default' before admitting or rejecting an application under Section 9 that whether the 'dispute' raised by corporate debtor qualify as a 'dispute' as defined under Section 5(6) and whether notice of dispute given by the corporate debtor fulfilling the conditions stipulated in sub-section (2) of Section 8 of I&B Code, 2016. If the Adjudicating Authority finds that the notice of dispute lacks in particulars or does not raise a dispute, it may admit the application and if it apparently finds that the notice of dispute does really raise a dispute and no other factual ascertainment is required then can reject the application.¹¹

In *Kirusa Software Private Ltd. Vs Mobilox Innovations Private Ltd.*,¹² learned Tribunal has rightly distinguished the provisions of Section 7 and Section 9 and highlighted the importance of the differences in both provisions and held that the true meaning of sub-section (2)(a) of Section 8 read with Section 5(6) of the 'I & B Code' clearly brings out the intent of the Code. It is clear that while Section 8(2) deals with "existence of a dispute", Section 9 (5) does not confer any discretion

on adjudicating authority to verify adequacy of the dispute. Mere a dispute giving a colour of genuine dispute or illusory, raised for the first time while replying to the notice under Section 8 cannot be a tool to reject an application under Section 9 if the operational creditor otherwise satisfies the adjudicating authority that there is a debt and there is a default on the part of the corporate debtor.

The basic principle behind such provisions in I & B Code is to avoid multiple proceedings as it is a fundamental principle of law. The definition of 'dispute' for the purpose of Section 9 must be read along with expression operational debt, which means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.¹³

The creditor initiating a corporate insolvency resolution process may propose a resolution professional to act as an interim resolution professional. Within fourteen days of the receipt of the application, the Adjudicating Authority shall admit or reject the application and communicate such decision.¹⁴ The date of admission of the application is the date of commencement of the process in this Code.¹⁵

The Learned Tribunal has gone into all related provisions to find intent of the Legislators and held that the scope of existence of 'dispute', if any, which includes pending suits and arbitration proceedings cannot be limited and confined to suit and arbitration proceedings only. It includes any other dispute raised prior to Section 8 in this in relation to clause (a) or (b) or (c) of sub-section (6) of Section 5. It must be raised in a court of law or authority and proposed to be moved before the court of law or authority and not any got up or malafide dispute just to stall the insolvency resolution process. In this case the matter rightly got remitted back to the adjudicating authority.¹⁶

V. Under Insolvency Resolution Process

Management of the affairs of corporate debtor will vest in the interim resolution professional, whose appointment is mandatory under the Code. As per statutory provision there has to be public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims.¹⁷ The interim resolution professional has duty to constitute a committee of creditors, which shall comprise all financial creditors of the corporate debtor after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor.

It is duty of the interim resolution professional to collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor and to make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern.

VI. Moratorium

The moratorium is for 180 days or till the debtor and creditor agree on a repayment plan, whichever is earlier. It is important to note that certain restrictions apply to the debtor in the moratorium period.¹⁸ The Code have specified restrictions on the debtor from the period of acceptance of application. Infact contravention of the restrictions imposed on the debtor is considered as offence.

VII. Permission to Withdraw the Application

Rules made under Statute makes the provision that adjudicating authority may permit the withdrawal of the application made as per Rule 6¹⁹ only if the request is made by the applicant before its admission.²⁰ When there is rule in place to give particulars of how debt was incurred by the corporate debtor, including particulars of any dispute as well as the record of pendency of suit or arbitration proceedings²¹ with application itself, means the authority need to know every relevant information before admission and there should not be any disclosure afterwards. There is no provision which can give right to applicant to withdraw the application, in case of Bankruptcy order for individual and partnership firm under Chapter IV, it is stated that the bankruptcy by the debtor shall not be withdrawn without the leave of the Adjudicating Authority.²²

In the matter of Hannifin India Private Limited v/s Prowess International Private Limited,²³ the application was filed under Sec 9 of the I & B Code, which was admitted by the adjudicatory authority and an interim insolvency resolution professional got appointed, consequently, the moratorium started as per provisions of the Code. As per direction public announcement was made and progress report was also submitted by the interim insolvency resolution professional.

At this stage the operational debtor filed application to withdraw the petition on the ground there is some settlement in between operational debtor and operational creditor, which was rightly rejected by the learned NCLT with observation that after the admission of the petition, it acquires the character of representative suit. Further, after publication other creditors get right to participate in the insolvency resolution process, therefore, petition cannot be dismissed on the basis of compromise between the operational creditor and corporate debtor.

Section 9(5)(ii)(b) of the I & B Code makes provision of rejection of the application if repayment of the debt amount is made by the corporate debtor before admission of the petition but once it is admitted the procedure prescribed in the Statute has to take its own course. The Code has specified limitation at every stage, that itself shows intention of the law makers for not giving discretion to interrupt the process in between commencement at end of days prescribed in the Code. There are more reasons than rejecting it on the ground of representative suit alone.

VIII. The Final Word

The I & B Code 2016 is an important law which will have strong impact on business world and will bound to have huge economic impact, therefore this Code need to be interpreted as per principles established in Shivashakti Sugars Limited²⁴. It was held in the aforesaid case that first duty of the Court is to decide the case by applying the statutory provisions. However, on the application of law and while interpreting a particular provision, economic impact/effect of a decision, wherever warranted, has to be kept in mind. It was further held that in a situation where two views are possible or wherever there is a discretion given to the Court by law, the Court needs to lean in favour of a particular view which subserves the economic interest of the nation. The observation of the Hon'ble Court has to be appreciated which said that the Court needs to avoid that particular outcome which has a potential to create an adverse affect on employment, growth of infrastructure or economy or the revenue of the State. As we all know that the power given to operation creditor to trigger the insolvency process has happened for the first time in India under I & B Code 2016 and one can be hopeful that this law will have huge impact of the industry and it will play a remarkable role in economic reform in time to come.

References

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2. Justice A. K. Sikri in the case of Shivashakti Sugars Limited Vs Shree Renuka Sugar Limited & Ors., Civil appeal No. 5040 of 2014, decided on 09.05.2017.
3. The report of the Bankruptcy Law Reforms Committee Volume I, Rationale and Design, November 2015, which was constituted by the Department of Economic Affairs to study the corporate bankruptcy legal framework in India and to submit a report.
4. For overview of the Insolvency and Bankruptcy Code 2016, read my blog published by Legal Era Magazine entitled, "The Insolvency And Bankruptcy Code 2016: Better Late Than Never".
5. For understanding mechanism in detail, one can read a paper published by me which is available at <http://swarupama.blogspot.in/2017/02/mechanism-for-corporate-insolvency.html>
6. Sec 8. Insolvency resolution by operational creditor: (1) An operational creditor may, on the occurrence of a default, deliver a demand notice of unpaid operational debtor copy of an invoice demanding payment of the amount involved in the default to the corporate debtor in such form and manner as may be prescribed. (2) The corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor — (a) existence of a dispute, if any, and record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to 5 such dispute; (b) the repayment of unpaid operational debt— (i) by sending an attested copy of the record of electronic transfer of the unpaid amount from the bank account of the corporate debtor; or (ii) by sending an attested copy of record that the operational creditor has 10 encashed a cheque issued by the corporate debtor.
7. Section 3(12) "default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be.
8. Section 3(11) "debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.
9. Section 3(6) of the Code defines "claim" to mean a right to payment and included within its ambit disputed and undisputed, legal, equitable, secured, including arising out of breach of contract.
10. Sec 9. Application for initiation of corporate insolvency resolution process by operational creditor. (1) After the expiry of the period of ten days from the date of delivery of the notice or invoice demanding payment under sub-section (1) of section 8, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute under sub-section (2) of section 8, the operational creditor may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process.
11. NCLAT judgement dated 24th May 2017 in the case of Kirusa Software Private Ltd. Vs Mobilox Innovations Private Ltd., Company Appeal (AT) (Insolvency) 6 of 2017.
12. Company Appeal (AT) (Insolvency) 6 of 2017, decided by NCLAT by its order dated 24th May 2017.
13. Sec 3 (21) of the I & B Code 2016.
14. Sec 9. (4) An operational creditor initiating a corporate insolvency resolution process under this section, may propose a resolution professional to act as an interim resolution professional. (5) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), by an order— (i) admit the application and communicate such decision to the operational creditor and the corporate debtor if, (a) the application made under sub-section (2) is complete; (b) there is no repayment of the unpaid operational debt; (c) the invoice or notice for payment to the corporate debtor has been 40 delivered by the operational creditor; (d) no notice of dispute has been received by the operational creditor or there is no record of dispute in the information utility; and (e) there is no disciplinary proceeding pending against any resolution professional proposed under sub-section (4), if any. (ii) reject the application and communicate such decision to the operational creditor and the corporate debtor, if (a) the application made under sub-section (2) is incomplete; (b) there has been repayment of the unpaid operational debt; (c) the creditor has not delivered the invoice or notice for payment to the corporate debtor; (d) notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility; or (e) any disciplinary proceeding is pending against any proposed resolution professional: Provided that Adjudicating Authority, shall before rejecting an application under sub- clause (a) of clause (ii) give a notice to the applicant to rectify the defect in his application within seven days of the date of receipt of such notice from the adjudicating Authority.
15. Sec 9 (6). The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5) of this section.
16. NCLAT judgement dated 24th May 2017 in the case of Kirusa Software Private Ltd. Vs Mobilox Innovations Private Ltd., Company Appeal (AT) (Insolvency) 6 of 2017.
17. Sec 13. (1) The Adjudicating Authority, after admission of the application under section 7 or section 9 or section

- 10, shall, by an order —(a) declare a moratorium for the purposes referred to in section 14; (b) cause a public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims under section 15; and Declaration of moratorium and public announcement. (c) appoint an interim resolution professional in the manner as laid down in section 16. (2) The public announcement referred to in clause (b) of sub-section (1) shall be made immediately after the appointment of the interim resolution professional.
18. Sec 14. (1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority; (b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein; (c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor. (2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period. (3) The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator. (4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:
 19. Rule 6 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 notified by Ministry of Corporate Affairs on 30th November, 2016. Application by operational creditor.—(1) An operational creditor, shall make an application for initiating the corporate insolvency resolution process against a corporate debtor under section 9 of the Code in Form 5, accompanied with documents and records required therein and as specified in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. (2) The applicant under sub-rule (1) shall dispatch forthwith, a copy of the application filed with the Adjudicating Authority, by registered post or speed post to the registered office of the corporate debtor.
 20. Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 notified by Ministry of Corporate Affairs on 30th November, 2016.
 21. Point. No. 2 of the Annexure format attached to the proof of claim submitted by authorized representative of workmen and employees given under Regulation 9 of the Insolvency and Bankruptcy (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 notified by Insolvency and Bankruptcy Board of India on 30th November, 2016.
Section 122(4) of the I & B Code 2016 An application for bankruptcy by the debtor shall not be withdrawn without the leave of the Adjudicating Authority.
 23. CP 150 of 2017 decided by NCLT Kolkata Bench Kolkata in its order dated 25.05.2017.
 24. Shivashakti Sugars Limited Vs Shree Renuka Sugar Limited & Ors., Civil appeal No. 5040 of 2014, decided on 09.05.2017