Insolvency and Bankruptcy Code and impact on existing BIFR schemes

In this article, an attempt has been made by the author to study the broad provisions of the Code (as defined hereinunder) and also examine the status of the cases pending under Sick Industrial Companies Act, 1985, in light of the recent judgement passed by the Hon'ble National Company Law Tribunal, Mumbai Bench ("**NCLT**" or "**Tribunal**") in the case of SM Dyechem Limited (**"Judgment"**).

Introduction and basics of Code:

One of the key factors that holds back the credit market is the mechanism of resolving insolvency or failure of a borrower to make good the promise made to the lenders. The structure of the bankruptcy and insolvency process in India before the enactment of the Insolvency and Bankruptcy Code, 2016 ("**Code"**) was elaborative, multi-layered, scrappy and complex. The legislative process was covered over various multiple laws and so the adjudication took place in multiple flora. The Presidency Towns Insolvency Act, 1909 covered the insolvency of individuals, partnership firms and association of individuals in three erstwhile presidency towns of Chennai, Kolkata and Mumbai and whereas The Provincial Insolvency Act, 1920 was the Insolvency laws for areas other than the aforesaid presidency towns. The laws covering corporate insolvency were (i) The Companies Act, 1956; *(winding-up & Strike-off of Companies)* (ii) Sick Industrial Companies Act, 1985 ("**SICA**") *(that focused solely on restructuring of sick industrial companies)*; (iii) Recovery of Debts due to Banks and Financial Institution Act, 1993; and (iv) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

The above list of the Insolvency framework is only illustrative and not exhaustive as there were various other attempts made in this regard, for example: the Reserve Bank of India ("**RBI**") had set up the following three mechanisms to allow banks to recover their due from corporate borrowers:-

(i) Corporate Debt Restructuring Process *(for facilitating out of court settlement between the debtor and the creditor bank)*;

(ii) Joint Lenders Forum *(for facilitating the adoption of a comprehensive banking system)*; and

(iii) Strategic Debt Restructuring *(which enables banks to convert their credit facility to a firm into equity and execute a change in the management of the firm)*.

The case of ***BHEL v/s Arunachalam Sugar Mills*** the Hon'ble Madras High Court in 2011 observed a textbook example of multiplicity of laws, parallel proceedings and conflicts. In the said instance, Arunachalam Sugar Mills and its sister concern defaulted on the credit facilities advanced and that gave rise to several akin proceedings by secured and unsecured creditors. Some of the proceedings included:

- A bank (being the main secured creditor) filed an application for debt recovery with Debt Recovery Tribunal;
- One of the other secured creditor entered into a memorandum of understanding with the bank, for the bank to sell the debtor's properties and pay the secured creditor its due from the proceeds;
- Another creditor filed a petition for winding-up of the Company;
- The company that had leased machinery initiated proceedings invoking the arbitration clause in the agreement and simultaneously filed an application in the high court restraining the debtor from selling and/or transferring its assets;
- The secured creditors of the Arunachalam Sugar Mills sister concern initiated proceedings under SARFAESI Act and not only took possession of its assets but also sold the same through an auction;
- The unsecured creditor that had supplied boilers filed a civil suit for recovery of money due, by sale of immovable properties.

To add to the above list, application were filed to the Board of Industrial and Financial Restructuring ("**BIFR**" or "**Board**") and a simultaneously application by creditor for winding-up / under SARFAESI.

Apart from consolidating the multiplicity of laws, parallel proceedings and conflicts, various other factors that complimented in support of the new framework (i.e. the Code) were the problems of (i) delay in disposal insolvency and bankruptcy cases; (ii) substantial reduction in the value of the assets of the debtor; (iii) difficulty in the exit route thereby affecting foreign investments; and (iv) various other legal and economic issues including the mounting non-performing assets plaguing the Indian banking system. The beleaguered ranking in 'Doing Business in India' on the Insolvency parameters also played its role in the process.

Before we move ahead to understand the corporate insolvency resolution process under the new code and analyze the aforesaid order of the NCLT let us first briefly run through the rehabilitation process under SICA.

Snapshot of the evolution SICA & process under SICA

In 1980, the Tiwari Committee was set up to recommend legislative and administrative remedies to the problem of industrial sickness.

At an elementary level the term 'industrial sickness' means an industrial or manufacturing firm performing systematically worse than the average, not covering its fixed cost and frequently defaulting on its debt repayment obligation.

The committee submitted its report to the government in September 1983 and suggested the following: (i) Need for a special legislation; and (ii) Need for setting-up of exclusive quasi-judicial body. The need for a special legislation gave birth to SICA and the need for setting-up of exclusive quasi-judicial body brought into existence of the Board for Industrial and Financial Reconstruction ("**BIFR**") in the year 1987.

One of the main objectives of SICA was to allow timely detection of sick and potentially sick companies, to expeditiously provide preventive, ameliorative, remedial and other measures and to organize affairs & promote fast reorganization of sick industrial companies.

Under SICA, an industrial undertaking on becoming sick could refer a reference under section 15(1) of SICA before BIFR constituted under SICA. It is important to note that only **Industrial Undertakings** were granted coverage under SICA. BIFR, on admitting such a reference, was supposed to undertake the exercise whether such a sick company can be revived or not. For this purpose, BIFR would appoint an operating agency ("**OA**") which was supposed to explore the possibility of the revival plan in consultation with other stakeholders, particularly the creditors and prepare a revival scheme. If such revival scheme prepared by the OA was found to be feasible by BIFR, after ascertaining the views/objections of the concerned parties, BIFR would sanction such a scheme. If it was not possible, BIFR would recommend winding-up of the sick company by making a reference to the jurisdictional High Court. There was a provision for an appeal before the Appellate Authority for Industrial and Financial Reconstruction ("**AAIFR**") which is to be made within forty-five(45) days from the receipt of the order of BIFR.

Repeal of SICA

However, the framework of SICA needed a revamp and many were in favor of its abolishment. Accordingly, The Sick Industrial Companies (Special Provisions) Repeal Act, 2003 was enacted to repeal SICA and whereas at the same time the corresponding provisions were sought to be incorporated in the Companies Act, 1956 by the enactment of the Companies (Second Amendment) Act, 2002, which called for insertion of Part VIA in the Companies Act, 1956. However, neither the Companies (Second Amendment) Act, 2002, nor the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 was enforced due to legal challenges. Finally, by a notification dated 25th November 2016, the Ministry of Finance enforced the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 and thereby repealed SICA with effect from 1st December 2016.

Aphoristic on the new Code

The Code is a single unified legislature to resolve insolvency for all Companies, Limited Liability Partnerships, Partnership Firms and Individuals & thereby balancing the competing interest of debtors, secured creditors and other stakeholders. Importantly, the Code specifically excludes Persons providing financial services from its purview and hence no insolvency proceeding can be initiated against such companies. At its core are 3 (three) fundamental principles:

(i) a business can and will fail and that all failure is not fraud;

(ii) insolvency resolution is commercial decision best left to the collectively by the creditors; and

(iii) predictability in the resolution process and the resolution outcomes improves the overall credit ecosystem.

The Code seeks to: (i) consolidate and amend laws relating to reorganization and insolvency resolution in India; (ii) protect the interest of the small investors; (iii) make the process time bound, (iv) maximize the value of the assets of the debtor, etc.

With respect to corporate debtors the Code recognizes two stages: (i) the Insolvency Resolution stage and (ii) Liquidation stage *(only when the revival of the corporate debtor cannot be achieved)*. The Insolvency resolution process would typically start in case of a corporate debtor on occurrence of a default *(where the amount of defaults is atleast Rs. 1 lakh)*. So, whenever there is a default by a corporate debtor the Code provides a right to the creditor to make an application to the Adjudicating Authority *(viz. the National Company Law Tribunal having territorial jurisdiction over the place where the registered office of the corporate debtor is located)* for initiating the corporate insolvency resolution process. For this purpose the Code categorizes the creditors in two(2) different categories –

(i) Financial creditors; and
(ii) Operational creditors.

The Code also lays down a process by which the corporate firms in financial distress can himself seek a resolution or an exit on the occurrence of a default. Explicably the plea for initiating insolvency can be submitted by the (i) the financial creditor; (ii) the operational creditor and (iii) the corporate debtor himself.

What we are concerned here is the Corporate Insolvency Process initiated by the corporate debtor himself and this is what exactly we are going to discuss in depth.

Process under the Code

The application for initiating the insolvency resolution process by the corporate debtor himself to the Adjudicating Authority is covered under Section 10 of the Code read with Rule 7 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. On receipt of the application the corporate debtor shall within fourteen (14) days by an order either admit *(if the application is complete)* or reject *(if it is incomplete)* the application. However, the Adjudicating Authority before rejecting an application notifies the applicant to rectify the defects within seven(7) days. The corporate insolvency resolution process commences from the date of admission of the order and a moratorium is declared. On admission the Adjudicating Authority appoints the Insolvency Resolution Professional proposed by the corporate debtor in its application as the Interim Resolution Professional ("**IRP**") and from the date of the appointment of IRP the powers of the Board of Directors stand suspended and shall vest with the IRP.

The IRP shall then within three (3) days from the date of his appointment make a public announcement calling upon creditors of the corporate debtors to submit their proof of claims. The IRP is responsible collate and verify all claims received from the creditors against the corporate debtor within seven (7) days from the last date of receipt of the claim and thereupon to prepare and maintain a list of creditor. The IRP is then required to constitute the committee of creditors which shall comprise of Financial creditors only. However, if the corporate debtor does not have any Financial creditor(s) then the committee shall consist of only Operational creditors and shall be constituted in accordance with Regulation 16 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. The IRP is to convene the first meeting of the committee of creditors within seven (7) days of the constitution of the committee of creditors and the committee shall at its first meeting *(by atleast 75% vote)* either appoint the IRP as the resolution professional ("**RP**") or replace the IRP by another RP.

The RP appointed by the committee of Creditors shall now be responsible to conclude the entire insolvency resolution process in accordance with the nuances of the Code and rules and regulations made thereunder.

The entire corporate insolvency resolution process is to be completed within one hundred & eighty (180) days from the date of admission of the application by the Adjudicating Authority to initiate the corporate insolvency resolution process. The said period of one hundred & eighty(180) days can be further extended *(only once)* to a further period of ninety(90) days by an application to the Adjudicating Authority on the basis of the resolution passed by 75% of the creditors having voting rights at the meeting.

A pertinent question arises in relation to the status of schemes which are nearly approved in the SICA regime. Would the IBC process be commenced afresh under the new regime?

Analysis of the Judgement

Brief Facts of the Case:

SM Dyechem Limited ("**SDML**" or the "**Applicant**"), incorporated in the year 1982, was engaged in the manufacturing of speciality chemicals, snack foods and soya oils. It undertook the diversification scheme in 1990 by setting up an alcohol based glycol plant at kurkumbh, in the state of Maharashtra to manufacture Ethylene Oxide (EO) and Mono Ethylene Glycol (MEG) with an installed capacity of 60000 tpa. The estimated project cost was Rs. 275 crores, however, the project got completed in the year 1993 with an actual cost of Rs. 388 crores of which Rs. 218 crores were part financed by term loan.

Completion of the project coincided with decontrol of molasses / alcohol prices. This coupled with substantial fall in the domestic prices of MEG, thereby rendering the project unviable from its inception. The plant worked intermittently for few years and was lying closed since March 1996. A reference under Section 15(1) of SICA was made by SDML to BIFR and thereafter in March 1998 BIFR declared SDML as sick and IDBI was appointed as the OA.

Since, several attempts for revival of SDML including issue of advertisement for change of management did not yield any results, BIFR confirmed winding-up of SDML at its hearing held in June 2003. Aggrieved by the order of BIFR, SDML filed an appeal with AAIFR. Before the matter was put for hearing SDML sold some of its divisions and payments received against such sale were used to meet off the liabilities of the secured creditors. AAIFR at the hearing held that SDML had not only settled its dues with secured creditors but has also reduced its liabilities considerably and is thus on the path of revival. Accordingly, AAIFR set aside the impugned order for winding-up of SDML and directed BIFR to formulate a suitable scheme by 31st March 2007. Further, on 28th May 2008, the circulated Draft Rehabilitation Scheme was sanctioned by BIFR.

Under the said sanctioned scheme, SDML was granted several concessions for repayment of its outstanding dues to creditors by BIFR and in Pursuance of which SDML had made payments equivalent to Rs. 150.71 crores out of its total liability of Rs. 152.84 crores. Though the sanctioned scheme was substantially implemented but due to non-grant of waiver of interest & penalty by sales tax department and PF Department coupled with other the financial difficulties continued to be faced by SDML, the balance funds required for its revival could not be inducted as a result of which the scheme could not be implemented and the anticipation that the losses would be wiped out by the year 2013 was not encountered. As a result of which, BIFR in exercise of its power under section 18(12) of SICA passed an order dated 31st October 2013 directing to, *"submit fully tied up Modified Draft Resolution Scheme ("**MDRS**") incorporating the dues of Sales Tax Department and other Liabilities, to IDBI (MA) within 6 weeks".*

Having said that, SDML in the process of identifying and negotiating with a strategic investor filed MDRS after a delay of nearly eighteen(18) months. The said MDRS was approved by OA and thereafter was forwarded to BIFR with OA's recommendation that the MDRS may be considered for approval. In the meanwhile, SDML filed a Miscellaneous Application before BIFR to condone the delay in filing the MDRS wherein BIFR observed that that it has no locus over the issue of MDRS, as the scheme period in this case has already expired long ago and that the Board cannot review its own order. BIFR still inter alia directed SDML to, *"prepare another MDRS, within a period of one(1) month, by way of taking reliefs and concessions from statutory / Govt. authorities as per their respective approved standard policies, and submit the same to MA(IDBI), who would examine the same and hold a joint meeting with the concerned agencies, and prepare a fully tied-up MDRS, if emerge, after incorporating the required changes, and submit the same to Board's office for its further examination, within a further period one (1) month*".

SDML aggrieved by order of BIFR preferred an appeal to AAIFR stating that MDRS has already been filed and the Miscellaneous Application was merely to condone the delay. AAIFR after hearing directed BIFR that the MDRS filed by SDML should be considered on its merits without being influenced in any manner.

Thereafter, before the matter be heard by BIFR for approval of MDRS, changes in the law occurred and vide notification dated 25th November 2016, the Ministry of Finance enforced Sick Industrial Companies (Special

Provisions) Repeal Act, 2003 ("**Repeal Act**") and thereby repealed SICA with effective date of 1st December 2016. The proceedings pending before BIFR were transferred to National Company Law Tribunal. Vide another notification from Ministry of Corporate Affairs dated 24th May 2017 any scheme sanctioned by BIFR or schemes already under implementation were deemed to be an 'Approved Resolution Plan' under section 31(1) of the Code.

SDML preferred a Miscellaneous Application to NCLT and as an abundant precaution simultaneously filed an application *(in Form 6)* under section 10 of the Code for permission to carry out the corporate insolvency resolution process from the stage it was left before BIFR and other authorities due to repeal of SICA. In the Miscellaneous Application several prayers were made, inter alia, (i) to consider the sanctioned scheme as the 'Approved Resolution Plan' under section 31 of the Code; (ii) to consider MDRS as a 'Resolution Plan' in terms of section 30 of the Code and thereafter be considered for approval in terms of section 31 of the Code and if the Tribunal is of the opinion that MDRS as approved by OA cannot be treated as the draft resolution plan then the application made under section 10 *(in Form 6)* be considered from the stage it was pending before the Hon'ble BIFR (i.e. MDRS being placed equivalent to the Resolution Plan under section 30 of the Code and then be considered for approval.

Legal Points before Hon'ble Tribunal for consideration

The two legal issues raised from the application were:

(i) Whether the petition is 'Maintainable under section 10' of the Code when BIFR proceedings were finalized in respect of part of the outstanding debt?

(ii) Whether the Insolvency Resolution Process be commenced in respect of the entire debt or confined to the part of the debt which is not considered of adjudicated upon by the authorities of SICA?

Notings by NCLT

The Tribunal noticed a proximity in the intentions of incorporation of SICA and the Code. The discoveries of the Tribunal with respect to proximity in the intentions of incorporation are as under:

- both SICA and the Code provides for rehabilitation/revival of the company, the difference being that under SICA it was to be formulated by the Board and whereas under the Code the restructuring is to be formulated by Insolvency Resolution Professional;

- the financial institutions, banks, etc. were termed as "Operating Agencies" under SICA and whereas under the Code the lingo used is "Resolution Professional". Tribunal further notices that there is kay departure as the Insolvency Resolution Professional is an independent person as against the Operating Agency;

- SICA provided that the revival scheme is to be proposed within ninety(90) days and whereas the Code has laid down a period of one hundred & eighty(180) days;

- SICA took measures for management of the company and the Code provides for the management of the company to vest with the Insolvency Resolution Professional immediately on commencement of corporate insolvency resolution process;

- measures for revival of the stressed company are almost identical under the provision of SICA and under the Code.

The Tribunal moves further ahead to state that the above illustrations are only demonstrative and not exhaustive. Important to note here that the Tribunal has formed an opinion that there are other similarities as well in the intention of the incorporation of SICA and the Code.

The Tribunal by citing the case *'Hyderabad Abrasives & Minerals Vs. Andhra Cements Ltd. (2003 42 SCL 748 AP)'* states that if there are certain proceedings or measures already have already been taken place under SICA or by an order of BIFR or AAIFR, then those resolutions or directions are not to be ignored, rather, are helpful for speedy resolution under the Code, because the intentions and process involved seems to be akin to each other.

Important to note here, that, the order of the case *'Hyderabad Abrasives & Minerals Vs. Andhra Cements Ltd. (2003 42 SCL 748 AP)'* which the Tribunal relied

upon mentions that a scheme approved by BIFR when under implementation can be modified by BIFR in accordance with section 18(3)(b) of SICA and so the implementation is a continuous process and that even if the time-period allotted under the scheme sanctioned by BIFR for settlement of dues has expired the protection granted under the scheme to the company does not diminish.

Verdict of the Tribunal

The order from the Tribunal clearly stated that it appears to be very logical that if a company has already undertaken a rehabilitation plan which could not be finalized for whatever reasons, then the repetition of those very steps has no logic & is not going to get any legal sanctity, rather, it would hamper or thwart the process and therefore an **'Altogether fresh exercise is not warranted'**, which may lead to undue embarrassment to the new investor who proposes to rehabilitate SDML and its debts. Hence the **steps taken under SICA should be honored and recognized under the Code.**

The application under section 10 of the Code was admitted and the Miscellaneous Application was made absolute to the extent directed.

Since the application was admitted the commencement of corporate insolvency resolution process was declared, the Insolvency Resolution Professional was appointed, and a moratorium was professed.

Sanctioned scheme under SICA was deemed to be an **'Approved Resolution Plan'** under section 31 of the Code.

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