# Indian Institute of Insolvency Professionals of ICAI (IIIPI)

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## IIIPI Case Update #7 October 2017


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2. In view of Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, the National Company Law Appellate Tribunal (NCLAT) could not utilise the inherent power recognised by Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 - **Lokhandwala Kataria Construction Pvt. Ltd. (Supreme Court)**

### SUPREME COURT OF INDIA

**M/s. Innoventive Industries Ltd. (Appellant/Corporate Debtor)**

**Vs.**

**ICICI Bank & Anr. (Respondents/Financial Creditor)**

**Date of Order: 31-08-2017**

Section 238 of the Insolvency and Bankruptcy Code, 2016 read with Section 4 of the Maharashtra Relief Undertaking (Special Provisions) Act, 1958 read with Article 254 of the Constitution of India – Provision of this Code to override other Laws

In its order dated 17th January 2017 the NCLT held that the Insolvency and Bankruptcy Code, 2016 (Code) would prevail against the Maharashtra Relief Undertaking (Special Provisions) Act, 1958 (Maharashtra Act) in view of the non-obstante clause in Section 238 of the Code. It, has further, held that the Parliamentary statute would prevail over the State statute and this being so; it is obvious that the corporate debtor had defaulted in making payments, as per the evidence placed by the financial creditors. Hence, the application was admitted and a moratorium was declared. The second application with a different plea filed by the Corporate Debtor was rejected by the NCLT vide its order dated 23rd January 2017 on the ground that it was filed belatedly and thus, not maintainable.

On appeal, the NCLAT upheld the order passed by the NCLT, however, held that the Code and the Maharashtra Act operate in different fields and, therefore, are not repugnant to each other and therefore, the appellant cannot derive any advantage from the Maharashtra Act to stall the insolvency resolution process under Section 7 of the Code.

The appellant/Corporate Debtor filed this appeal before the Supreme Court against the order of NCLAT which had upheld the order passed by the NCLT.

On maintainability of the appeal the Apex Court held:

> Once an insolvency professional is appointed to manage the company, the erstwhile directors who are no longer in management, obviously cannot maintain an appeal on behalf of the company. In the present case, the company is the sole appellant. This being the case, the present appeal is obviously not maintainable.
>
> However, we are not inclined to dismiss the appeal on this score alone. Because this is the very first application that has been moved under the Code, we thought it necessary to deliver a detailed judgment so that all Courts and Tribunals may take notice of a paradigm shift in the law.
>
> Entrenched managements are no longer allowed to continue in management if they cannot pay their debts.

After going through the Statement of Objects & reasons and various relevant provisions of the Code the Supreme Court held as follows:

The Insolvency and Bankruptcy Code, 2016 has been passed after great deliberation and pursuant to various committee reports. One of the important objectives of the Code is to bring the insolvency law in India under a single unified umbrella with the object of speeding up of the insolvency process. The scheme of the Code is to ensure that when a default takes place, in the sense that a debt becomes due and is not paid, the insolvency resolution process begins. The Code gets triggered the moment default is of rupees one lakh or more (Section 4). The corporate insolvency resolution process may be triggered by the corporate debtor itself or a financial creditor or operational creditor.

The scheme of Section 7 stands in contrast with the scheme under Section 8 where an operational creditor is, on the occurrence of a default, to first deliver a demand notice of the unpaid debt to the operational debtor in the manner provided in Section 8(1) of the Code. Under Section 8(2), the corporate debtor can, within a period of 10 days of receipt of the demand notice or copy of the invoice mentioned in sub-section (1), bring to the notice of the operational creditor the existence of a dispute or the record of the pendency of a suit or arbitration proceedings, which is pre-existing – i.e. before such notice or invoice was received by the corporate debtor. The moment there is existence of such a dispute, the operational creditor gets out of the clutches of the Code.

On the other hand, in the case of a corporate debtor who commits a default of a financial debt, the adjudicating authority has merely to see the records of the information utility or other evidence produced by the financial creditor to satisfy itself that a default has occurred. It is of no matter that the debt is disputed so long as the debt is "due" i.e. payable unless interdicted by some law or has not yet become due in the sense that it is payable at some future date. It is only when this is proved to the satisfaction of the adjudicating authority that the adjudicating authority may reject an application and not otherwise.

The rest of the insolvency resolution process is also very important. The entire process is to be completed within a period of 180 days from the date of admission of the application under Section 12 and can only be extended beyond 180 days for a further period of not exceeding 90 days if the committee of creditors by a voting of 75% of voting shares so decides. It can be seen that time is of essence in seeing whether the corporate body can be put back on its feet, so as to stave off liquidation.

As soon as the application is admitted, a moratorium in terms of Section 14 of the Code is to be declared by the adjudicating authority and a public announcement is made stating, inter alia, the last date for submission of claims and the details of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims. Under Section 17, the erstwhile management of the corporate debtor is vested in an interim resolution professional who is a trained person registered under Chapter IV of the Code. This interim resolution professional is now to manage the operations of the corporate debtor as a going concern under the directions of a committee of creditors appointed under Section 21 of the Act. Decisions by this committee are to be taken by a vote of not less than 75% of the voting share of the financial creditors. Under Section 28, a resolution professional, who is none other than an interim resolution professional who is appointed to carry out the resolution process, is then given wide powers to raise finances, create security interests, etc. subject to prior approval of the committee of creditors.

Under Section 30, any person who is interested in putting the corporate body back on its feet may submit a resolution plan to the resolution professional, which is prepared on the basis of an information memorandum. This plan must provide for payment of insolvency resolution process costs, management of the affairs of the corporate debtor after approval of the plan, and implementation and supervision of the plan. It is only when such plan is approved by a vote of not less than 75% of the voting share of the financial creditors and the adjudicating authority is satisfied that the plan, as approved, meets the statutory requirements mentioned in Section 30, that it ultimately approves such plan, which is then binding on the corporate debtor as well as its employees, members, creditors, guarantors and other stakeholders. Importantly, and this is a major departure from previous legislation on the subject, the moment the adjudicating authority approves the resolution plan, the moratorium order passed by the authority under Section 14 shall cease to have effect.

The scheme of the Code, therefore, is to make an attempt, by divesting the erstwhile management of its powers and vesting it in a professional agency, to continue the business of the corporate body as a going concern until a resolution plan is drawn up, in which event the management is handed over under the plan so that the corporate body is able to pay back its debts and get back on its feet. All this is to be done within a period of 6 months with a maximum extension of another 90 days or else the chopper comes down and the liquidation process begins.

In answer to the application made under Section 7 of the Code, the appellant only raised the plea of suspension of its debt under the Maharashtra Act, which, therefore, was that no debt was due in law. The adjudicating authority correctly referred to the non-obstante clause in Section 238 and arrived at a conclusion that a notification under the Maharashtra Act would not stand in the way of the corporate insolvency resolution process under the Code.

After observing some of its earlier judgments the Supreme Court yield the following proposition:

i. Repugnancy under Article 254 arises only if both the Parliamentary (or existing law) and the State law are referable to List III in the 7th Schedule to the Constitution of India.

ii. In order to determine whether the Parliamentary (or existing law) is referable to the Concurrent List and whether the State law is also referable to the Concurrent List, the doctrine of pith and substance must be applied in order to find out as to where in pith and substance the competing statutes as a whole fall. It is only if both fall, as a whole, within the Concurrent List, that repugnancy can be applied to determine as to whether one particular statute or part thereof has to give way to the other.

iii. The question is what is the subject matter of the statutes in question and not as to which entry in List III the competing statutes are traceable, as the entries in List III are only fields of legislation; also, the language of Article 254 speaks of repugnancy not merely of a statute as a whole but also "any provision" thereof.

iv. Since there is a presumption in favour of the validity of statutes generally, the onus of showing that a statute is repugnant to another has to be on the party attacking its validity. It must not be forgotten that that every effort should be made to reconcile the competing statutes and construe them both so as to avoid repugnancy – care should be taken to see whether the two do not really operate in different fields qua different subject matters.

v. Repugnancy must exist in fact and not depend upon a mere possibility.

vi. Repugnancy may be direct in the sense that there is inconsistency in the actual terms of the competing statutes and there is, therefore, a direct conflict between two or more provisions of the competing statutes. In this sense, the inconsistency must be clear and direct and be of such a nature as to bring the two Acts or parts thereof into direct collision with each other, reaching a situation where it is impossible to obey the one without disobeying the other. This happens when two enactments produce different legal results when applied to the same facts.

vii. Though there may be no direct conflict, a State law may be inoperative because the Parliamentary law is intended to be a complete, exhaustive or exclusive code. In such a case, the State law is inconsistent and repugnant, even though obedience to both laws is possible, because so long as the State law is referable to the same subject matter as the Parliamentary law to any extent, it must give way. One test of seeing whether the subject matter of the Parliamentary law is encroached upon is to find out whether the Parliamentary statute has adopted a plan or scheme which will be hindered and/or obstructed by giving effect to the State law. It can then be said that the State law trenches upon the Parliamentary statute. Negatively put, where Parliamentary legislation does not purport to be exhaustive or unqualified, but itself permits or recognises other laws restricting or qualifying the general provisions made in it, there can be said to be no repugnancy.

viii. A conflict may arise when Parliamentary law and State law seek to exercise their powers over the same subject matter. This need not be in the form of a direct conflict, where one says "do" and the other says "don't". Laws under this head are repugnant even if the rule of conduct prescribed by both laws is identical. The test that has been applied in such cases is based on the principle on which the rule of implied repeal rests, namely, that if the subject matter of the State legislation or part thereof is identical with that of the Parliamentary legislation, so that they cannot both stand together, then the State legislation will be said to be repugnant to the Parliamentary legislation. However, if the State legislation or part thereof deals not with the matters which formed the subject matter of Parliamentary legislation but with other and distinct matters though of a cognate and allied nature, there is no repugnancy.

ix. Repugnant legislation by the State is void only to the extent of the repugnancy. In other words, only that portion of the State's statute which is found to be repugnant is to be declared void.

x. The only exception to the above is when it is found that a State legislation is repugnant to Parliamentary legislation or an existing law if the case falls within Article 254(2), and Presidential assent is received for State legislation, in which case State legislation prevails over Parliamentary legislation or an existing law within that State. Here again, the State law must give way to any subsequent Parliamentary law which adds to, amends, varies or repeals the law made by the legislature of the State, by virtue of the operation of Article 254(2) proviso.

After going through the Maharashtra Act, the Apex Court held that there is no doubt that this Maharashtra Act is referable to Entry 23, List III in the 7th Schedule to the Constitution. On the other hand, the Insolvency and Bankruptcy Code, 2016 is an Act to consolidate and amend the laws relating to reorganization and insolvency resolution, inter alia, of corporate persons. There can be no doubt, therefore, that the Code is a Parliamentary law that is an exhaustive code on the subject matter of insolvency in relation to corporate entities, and is made under Entry 9, List III in the 7th Schedule which reads as, "9. Bankruptcy and insolvency".

On reading its provisions, the moment initiation of the corporate insolvency resolution process takes place, a moratorium is announced by the adjudicating authority *vide* Sections 13 and 14 of the Code, by which institution of suits and pending proceedings etc. cannot be proceeded with. This continues until the approval of a resolution plan under Section 31 of the said Code. In the interim, an interim resolution professional is appointed under Section 16 to manage the affairs of corporate debtors under Section 17.

It is clear, therefore, that the earlier State law is repugnant to the later Parliamentary enactment as under the said State law, the State Government may take over the management of the relief undertaking, after which a temporary moratorium in much the same manner as that contained in Sections 13 and 14 of the Code takes place under Section 4 of the Maharashtra Act. There is no doubt that by giving effect to the State law, the aforesaid plan or scheme which may be adopted under the Parliamentary statute will directly be hindered and/or obstructed to that extent in that the management of the relief undertaking, which, if taken over by the State Government, would directly impede or come in the way of the taking over of the management of the corporate body by the interim resolution professional. Also, the moratorium imposed under Section 4 of the Maharashtra Act would directly clash with the moratorium to be issued under Sections 13 and 14 of the Code. It will be noticed that whereas the moratorium imposed under the Maharashtra Act is discretionary and may relate to one or more of the matters contained in Section 4(1), the moratorium imposed under the Code relates to all matters listed in Section 14 and follows as a matter of course. In the present case it is clear, therefore, that unless the Maharashtra Act is out of the way, the Parliamentary enactment will be hindered and obstructed in such a manner that it will not be possible to go ahead with the insolvency resolution process outlined in the Code. Further, the non-obstante clause contained in Section 4 of the Maharashtra Act cannot possibly be held to apply to the Central enactment, inasmuch as a matter of constitutional law, the later Central enactment being repugnant to the earlier State enactment by virtue of Article 254 (1), would operate to render the Maharashtra Act void vis-à-vis action taken under the later Central enactment.

On reading of section 238 of the code it is clear that the later non-obstante clause of the Parliamentary enactment will also prevail over the limited non-obstante clause contained in Section 4 of the Maharashtra Act. For these reasons, we are of the view that the Maharashtra Act cannot stand in the way of the corporate insolvency resolution process under the Code.

The appellant argued that the notification under the Maharashtra Act only kept in temporary abeyance the debt which would become due the moment the notification under the said Act ceases to have effect.

The Supreme Court however held that the notification under the Maharashtra Act continues for one year at a time and can go upto 15 years. Given the fact that the timeframe within which the company is either to be put back on its feet or is to go into liquidation is only 6 months, it is obvious that the period of one year or more of suspension of liability would completely unsettle the scheme of the Code and the object with which it was enacted, namely, to bring defaulter companies back to the commercial fold or otherwise face liquidation. If the moratorium imposed by the Maharashtra Act were to continue from one year upto 15 years, the whole scheme and object of the Code would be set at naught.

The appellant then argued that since the suspension of the debt took place from July, 2015 onwards, the appellant had a vested right which could not be interfered with by the Code.

The Supreme Court however held that it is precisely for this reason that the non-obstante clause, in the widest terms possible, is contained in Section 238 of the Code, so that any right of the corporate debtor under any other law cannot come in the way of the Code. For all these reasons, we are of the view that the Tribunal was correct in appreciating that there would be repugnancy between the provisions of the two enactments. The judgment of the Appellate Tribunal is not correct on this score because repugnancy does exist in fact.

As regards to the rejection of second application the Tribunal as well as the Appellate Tribunal it was held by the Apex Court that the Tribunal and the Appellate Tribunal were right in not going into this contention for the very good reason that the period of 14 days within which the application is to be decided was long over by the time the second application was made before the Tribunal. Also, the second application clearly appears to be an after-thought for the reason that the corporate debtor was fully aware of the fact that the MRA had failed and could easily have pointed out these facts in the first application itself. However, for reasons best known to it, the appellant chose to take up only a law point before the Tribunal. The law point before the Tribunal was argued on 22nd and 23rd December, 2016, presumably with little success. It is only as an after-thought that the second application was then filed to add an additional string to a bow which appeared to the appellants to have already been broken.

The obligation of the corporate debtor was, therefore, unconditional and did not depend upon infusing of funds by the creditors into the appellant company. Also, the argument taken for the first time before us that no debt was in fact due under the MRA as it has not fallen due (owing to the default of the secured creditor) is not something that can be countenanced at this stage of the proceedings. In this view of the matter, we are of the considered view that the Tribunal and the Appellate Tribunal were right in admitting the application filed by the financial creditor ICICI Bank Ltd.

**Case Review:** Order dated 17th January, 2017 and Order dated 23rd January, 2017 passed by NCLT, Mumbai Bench, Mumbai in ICICI Bank Ltd. Vs. M/s. Innoventive Industries Ltd. (C.P. No. 1/I&BP/NCLT/MB/MAH/2016) and order dated 15th May 2017 passed by the NCLAT in M/s. Innoventive Industries Ltd. Vs. ICICI Bank Ltd. (reported in IIIPI Update 4, Part 2, June 2017), *Upheld.*

**SUPREME COURT OF INDIA**

**Lokhandwala Kataria Construction Pvt. Ltd. (Appellant/Corporate Debtor)**

**Vs.**

**Nisus Finance & Investment Manager LLP. (Financial Creditor)**

**Dated: 24-07-2017**

Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 read with Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 – Withdrawal of Application

An appeal was filed by the appellant/Corporate Debtor against the order passed by the Adjudicating Authority (NCLT, Mumbai Bench) whereby the application under section 7 of the Insolvency and Bankruptcy Code, 2016 (the Code) has been admitted. The parties submitted before the NCLAT that they have settled the dispute and part amount has already been paid. The NCLAT, however, held that such settlement cannot be ground to interfere with the impugned order in absence of any other infirmity. The NCLAT further held that Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 has not been adopted for the purpose of the Code and only Rules 20 and 26 have been adopted in absence of any specific inherent power and where there is no merit, the question of exercising inherent power does not arise.

On appeal, the Supreme Court held that:

In view of Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, the National Company Law Appellate Tribunal (NCLAT) could not utilise the inherent power recognised by Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 to allow a compromise before it by the parties after admission of the matter.

**Case Review:** Order dated 13th July 2017 passed by the NCLAT in Lokhandwala Kataria Construction Pvt. Ltd. Vs. Nisus Finance & Investment Manager LLP. in CA (AT) (Insolvency) No. 95 of 2017, *upheld.*

**Hope you find this Update helpful.**
**Suggestions if any, may be mailed to ipa@icai.in**