Supreme Court Ruling in Vidarbha Power Industries Limited: An Appreciation and A Critique

NCLTs act as an interface of the insolvency regime in India. They monitor processes under the IBC, 2016 (Code) and take crucial decisions. Whether NCLTs enjoy discretionary powers under the Code? If yes, to which extent? These issues have ignited debate after the Supreme Court judgement in the matter of M/s Vidharbha Industries Power Limited Vs. Axis Bank Limited (2022). Apprehensions are being raised on possible misinterpretation of the judgement by promoters of the CDs to delay the admission of CIRP, which may derail the main objective of the IBC,2016 i.e., resolution. After analyzing the pros and cons of the judgement, the author suggests an amendment in line with the UNCITRAL Legislative Guide on Insolvency Law, 2005. ***Read on to know more…***

Karthik Natarajan
The author is an Insolvency Professional (IP) Member of IIIPI. He can be reached at
cakarthiknatarajan@gmail.com

1. Introduction

Perhaps for the first time, the Supreme Court of India had the occasion to decide on the crucial aspect as to whether there was any elasticity permissible to the rigors of an admission to the Corporate Insolvency Resolution Process (CIRP) under Section 7 of the Insolvency and Bankruptcy Code 2016 (Code) despite there being occurrence of a default. This was observed by the Apex Court in its ruling rendered in July 2022 in the landmark case of *M/s Vidharbha Industries Power Limited (Corporate Debtor) Vs. Axis Bank Limited (Financial Creditor)*[1].

2. Facts of the Case

The Corporate Debtor (CD) was an electricity generating company, which had set up two units of coal-fired thermal power plant, each for 300 MW in Maharashtra. The tariff to be charged by such a company was determined by the State Electricity Regulatory Commission viz., the Maharashtra Electricity Regulatory Commission (MERC) in this case. So, in February 2013, the MERC had duly approved the Power Purchase Agreement including the tariff (which is based on cost-plus mark-up basis), permitting the CD to commercially sell the electricity it

[1] C.A. No. 4633 of 2021

generated. Later in January 2016, the CD sought to claim enhanced tariff inter-alia owing to what it claimed were increased fuel and operational costs. However, the MERC declined to approve the enhanced tariff. So, the Appellant went into appeal before the Appellate Tribunal for Electricity (APTEL), which approved the enhanced tariff calculations. It appears that the financial implications of this successful appeal would result in 1,730 crores due to the CD. But, pouring cold water on such gain, MERC carried the matter into appeal before the Apex Court, where the matter was pending at the time of judgement (the same was pending as of December 08, 2022).

Meanwhile, Axis Bank, being a Financial Creditor (FC), claimed that the CD had defaulted on dues amounting to 553 crores (499 crores being principal and the rest being interest). As the default had occurred, it filed a petition in January 2020, under the Code before National Company Law Tribunal (NCLT), Mumbai for initiation of CIRP against the CD. As a counter, the Appellant filed a Miscellaneous Application before the court seeking a stay of the proceedings under the Code, until its matter in the MERC appeal was decided by the Apex Court.

The NCLT, in January 2021, declined to stay the CIRP stating that under the Code, it had no discretion but to only see whether (a) there has been a debt and (b) the corporate borrower had defaulted in making the repayments. That's it, and no further. These two aspects, when satisfied, would trigger the CIRP. It also observed that "no extraneous matter" should come in the way of expeditiously deciding the petition under Section 7 of the Code. And that the inability of the CD in servicing the debts or the reason for committing a default "were alien to the scheme of the Code".

Even the National Company Law Appellate Tribunal (NCLAT) concurred with the NCLT's stand, citing that the "flow of legal process cannot be thwarted on considerations which are anterior to the mandate of Section 7(4) & (5) of the Code". Dissatisfied with these orders, the Appellant carried the matter to the Supreme Court.

3. Arguments and Counter Arguments before Supreme Court

The CD vehemently argued that (a) it was not able to pay the dues of the FC only because of the pending MERC appeal before the Supreme Court and (b) implementation of the orders of the APTEL would enable the CD to clear all its outstanding liabilities. Referring to Section 7(5)(a) of the Code, it contended that where the Adjudicating Authority (AA) i.e., NCLT was satisfied that a default has occurred, and the application under Sub-Section (2) was complete, and there was no disciplinary proceeding pending against the proposed Resolution Professional, AA may[2] by order, admit such application. Thus, it must be interpreted to say that it was not mandatory for the NCLT to admit an application in each and every case, where there was existence of a debt, thereby implying that it could reject the initiation of CIRP in fit conditions "for meeting the ends of justice and to achieve the overall objective of the IBC, which is revival of the company and value maximization". In short, it was argued that NCLT had the discretion to admit the CIRP and this was not a fit case to do so.

Per *contra*, the FC strongly contended that Section 7(5)(a) of the Code cast a mandatory obligation on the AA to admit an application of the FC, under Section 7(2), once it was found that a CD had committed default in repayment of its dues to the FC. Quoting from the celebrated ruling of the Apex Court in *Swiss Ribbons* [(2019) 4 SCC 17], it was stated that the trigger for a FC's application was non-payment of dues when they arose under loan agreements.

4. Ruling of the Supreme Court

Interestingly and pertinently, the Apex Court critically observed that the viability and overall financial health of the CD were not extraneous matters, particularly when there was a favourable order by the APTEL, which would have netted the CD 1,730 crores i.e., an amount which was far in excess of the dues (553 crores) to the FC. The Apex Court in this ruling has categorically held that whilst the existence of a default in servicing the financial debt only gave the FC a right to apply for initiation of the CIRP, yet, the NCLT, as the AA, was required to apply its mind to relevant factors including as in this case, the feasibility of initiation of CIRP against an electricity generating company operated under statutory control, the impact of MERC's appeal being *sub-judice*, favorable order of APTEL and the overall financial health and viability of the

[2] Emphasis supplied, the use of 'may' in contradistinction to 'shall' made the critical difference in this important matter

> **Apex Court critically observed that the viability and overall financial health of the CD were not extraneous matters, particularly when there was a favourable order fetching the CD more money than payable dues.**

CD under its existing management. The Court felt that these factors were germane enough for consideration by the subordinate courts in deciding the admissibility of the CIRP.

Concurring with the Appellant's contentions, the Apex Court ruled that a bare perusal of the aforesaid provision showed that the word used in Section 7(5)(a) of the Code is 'may' as opposed to 'shall', which must be interpreted to say that it was not mandatory for the NCLT to admit an application in each and every case, where there is existence of a debt. Effectively, the Supreme Court overturned the orders of the subordinate insolvency courts which refused to entertain a stay on the CIRP initiated by the FC owing to the occurrence of a default.

5. The Verdict: Author's Take

With due regards, the decision is a straightforward one in that the Supreme Court has upheld the first and foremost principle of interpretation of statute, which was the rule of 'literal interpretation'. The use of the word 'may' in Section 7(5)(a) in respect of an application for CIRP initiated by a FC against a CD in contradistinction to the expression 'shall' in the otherwise almost identical provision of Section 9(5) of the Code relating to the initiation of CIRP by an Operational Creditor (OC) clearly evidences the intent of the Legislature.

That the Legislature appreciates very well the value of the words they choose becomes evident from the following comparison also:

a) Section 7(1) of the Code reads that "A financial creditor either by itself or jointly with 2 [other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government] may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred."

b) Whereas Sub-Section (2) thereof reads that "The financial creditor shall make an application under sub-section (1) in such form and manner and accompanied with such fee as may be prescribed."

c) Similarly, Sub-Section (4) reads as "The Adjudicating Authority shall, within fourteen days of the receipt of the application under Sub-Section (2), ascertain the existence of a default from the records of an Information Utility (IU) or on the basis of other evidence furnished by the financial creditor under sub-section (3)".

This verdict also dovetails into the object of the Code which was to try and resuscitate the CD and not rush and pave the way for its eventual liquidation. So, where the solvency of the CD was not in question but appeared to be a temporary shortage of funds, then admitting the CIRP (which includes displacing the existing management) in such an instance would appear harsh and contrary to the avowed object of the Code.

Also, the reliance on *Swiss Ribbons* judgement *supra* as feeding into the mandatory admission to the CIRP ought to be displaced since in that case, the Apex Court was deciding questions relating to the constitutional validity of the Code and not the issue of 'may' versus 'shall' the present context. The obiter deployed (read pearls of wisdom) by the Court in the *Swiss Ribbons* judgement is an ultimate manifestation of one true and splendid majesty of the Court, erudition at its very best. Effectively, in this case, the Court espoused its stance that it must defer to legislative judgement in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgement appeared to be arbitrary. Be that as it may, the Court did not have the occasion to consider the technicalities of whether the use of the word 'may' in Section 7(5)(a) of the Code denoted mandatory admission by the NCLT. Thus, it becomes clear that there is no conflict of any sorts between these two judgements (both fundamental) of the Apex Court viz., *Vidharbha* Industries and *Swiss Ribbons* supra. What apparently causes the confusion is when certain obiter is quoted/read in isolation and taken out of perspective.

For instance, the use of language such as "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

"There is no conflict of any sorts between these two judgements of the Apex Court viz., Vidharbha Industries (2022) and Swiss Ribbons (2019). What apparently causes the confusion is when certain obiter is quoted/read in isolation and taken out of perspective."

insolvency resolution process begins" or "the moment the AA is satisfied that a default has occurred, the application must be admitted unless it is incomplete". However, it is trite that a judgment is a precedent only for the question of law that is raised and decided. The language used in a judgment cannot be read like a statute. In any case, words and phrases in the judgment cannot be construed in a truncated manner out of context.

6. The Verdict: Author's Perspective

a) Until now, it was understood that the moment there was a default in financial credit repayment and no adverse proceedings pending against the Resolution Professional (RP), CIRP process was to be admitted by the AA. But now, with this judgement, the NCLT will have to exercise discretionary power and judgement considering the facts and circumstances of each case before admission to CIRP. Despite the verdict in this case being what it is, yet, with humble regards, there are some concerns emanating from plausible future misinterpretation of this simple and straight forward judgement in the Vidharbha Industries case, which could stifle the significant gains made owing to the implementation of the Code and pose hindrance to the unstinted positive development of CIRP in India and therefore, a need is felt to stimulate a healthy discussion amongst the stakeholders. Here are a few such concerns:

b) Is it not trite that under the Code, the Legislative intent has moved away from the concept of "inability to pay" to "determination of default"[3] ? And the Design of the Code was intended deliberately "to facilitate the assessment of viability of the enterprise at a very early stage"[4] . If that be the situation accepted as ripe for CIRP, then, a default in servicing the financial debt would be the right time to admit the CIRP as otherwise, the motto of maximization of value for the stakeholders would be vitiated as the CD could very well hurtle towards further defaults of succeeding instalments too.

c) Effectively, what the ruling in the Vidarbha Industries case exhorts NCLT as the AA to ascertain whether there was a business failure (which is a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments) as well, besides the financial failure (a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though the business model is generating revenues). If there was no business failure, then the CIRP petition need not be admitted. It is humbly submitted that the Courts must oversee the CIRP through scrupulous adherence to the due process of the Code but not be burdened to make business decisions. After all, this was an important design feature[5] adopted by the Bankruptcy Law Reforms Committee while designing the Code framework.

d) The framers of the Code have chosen to adopt the test of insolvency as the trigger for CIRP as juxtaposed to the Balance Sheet test[6] . Reliance on this test is designed to activate insolvency proceedings sufficiently early in the period of the CD's financial distress to minimize dissipation of assets and avoid a race by creditors to grab assets that would cause dismemberment of the CD to the collective disadvantage of all creditors. Even the flow of Section 7 corroborates this. So, Sub-Section (1) paves the way for the FC to apply for CIRP either singly or jointly, Sub-Section (2) deals with the manner of such application, Sub-Section (3) exhorts the FC to enclose the proof of default to show insolvency, Sub-Section (4) mandates the NCLT to ascertain the existence of default and Sub-

[3] Para 64, Swiss Ribbons judgement *supra*
[4] Para 3.4.2, Principles driving the Design under 'Features of the Code', The Report of the Bankruptcy Law Reforms Committee, November 2015
[5] Para 3.4.2 *ibid*
[6] Mentioned in Part Two, B. Commencement Standards, Page 45 of the UNCITRAL Legislative Guide on Insolvency Law, 2005

Section (5) culminates with an approval/ rejection of the petition to admit the CIRP. Thus, in case the FC triggers the CIRP, the AA verifies the default from the Information Utility (if the default has been filed with an Information Utility as incontrovertible evidence of the existence of a default) or otherwise confirms the existence of default through the additional evidence adduced by the FC. Further, there is a time-limit of 14 days granted by the Code for such determination of default by NCLT. So, in sequence, if after the NCLT examines the records to ascertain the default, expecting the NCLT to again spend considerable time and significant effort in ascertaining the reasons for default would (i) stretch things afar, (ii) would be contrary to planned design of the Code and, (c) delay the whole process quite significantly.

"If the Legislature wanted the NCLT to ascertain the business reasons for the default and consider extraneous factors, then, surely it would have provided for it more explicitly in Sub-Section 5(b) to Section 7."

e) There is yet another way to look at this issue. If the Legislature wanted the NCLT to ascertain the business reasons for the default and consider extraneous factors, then, surely it would have provided for it more explicitly in Sub-Section 5(b) to Section 7. Currently, Clause (b) provides for a situation where if the NCLT is satisfied that (i) default has not occurred or (ii) the CIRP petition/application was incomplete or (iii) any disciplinary action was pending against the proposed Resolution Professional (RP), then only in such circumstances, the NCLT could reject the application to CIRP. So, it could be contended that there are no other factors germane for consideration in the rejection of an application. In the same vein, the use of the word 'may' in both limbs (a) and (b) to Section 7(5) could be linked only to the occurrence of the situations described above viz., no default established, incomplete CIRP application or pending disciplinary proceedings against the proposed Resolution Professional (RP). The use of the word 'may' in that sense would brook of no further elasticity and therefore, may not accord any further discretion to the AA in the matter of admitting the CIRP in relation to default concerning FC.

f) The problem with expecting NCLT to apply their mind to consider various germane factors in case of each and every petition for CIRP before admission is that no two case shall be same and therefore, it is feared that the entire exercise shall be held ransom to (i) incomplete furnishing of facts, (ii) frivolous means to delay the proceedings and (iii) the need to adhere to timelines in the conduct of the process. CDs may then vehemently try to stall/delay the process by bringing various factors which they may contend would merit consideration, stretching the time and efforts of the already over-burdened NCLT. In the absence of full facts, the NCLT may practically not have the wherewithal to delve deeper into the circumstances behind each default. And so, any decision based on such incomplete facts could turn to be miscarriage of justice, which needs to be avoided at all costs.

g) In the Vidharbha case, the Apex Court considered the pendency of a matter in the highest Court and also its likely financial implications. With humble regards, it is feared that this would be sure shot recipe for (mis)interpretation in all hues by the various subordinate Courts. For instance, a fairly old CD would have many matters under various laws, so which all cases would be germane for decision-making by the NCLT. In this case, the CD had a successful verdict to show from the APTEL. So, are we to then take it as a template that if the CD has a favorable verdict in the penultimate Court, then a stay needs to be granted for the CIRP application until the final verdict has come. Also, what would happen if there were multiple grounds, and the CD has received partially favourable verdict. Who will do and how will the quantification of the stake be worked out?

h) An argument does exist for consideration that when an account turns non-performing asset as

per the accepted prudential banking norms, already sizeable time has elapsed on the insolvency. So, elongating the process any further would only deteriorate the value of the assets of the insolvent CD. Pertinently, if the CD has defaulted in servicing the financial debt, that could preponderate the intent of the CD (unless proven otherwise) and could also pinpoint towards non-viability or malfeasance and therefore, allowing any further delay to the FC to seek insolvency resolution through the CIRP would be unfair to the latter.

Whilst the Code has succeeded for sure in giving a fillip to the credit climate in India with its time-bound nature and inherent aim of resolving the insolvency situation (rather than liquidation), there does remain the need to continue the momentum and not drop the guard in the administration of the Code by the stakeholders (Courts, IBBI, and the Practitioners).

A practical solution to addressing the challenge of discretion in this case has been attempted by the UNCITRAL Legislative Guide on Insolvency Law, 2005, where at para 24, page 46, the Report exhorts the Insolvency Law/Code to provide guidance for the Courts in this regard and to prevent a premature finding of insolvency, the relevant excerpt reads as follows:

"There is a need to bring an amendment in the insolvency framework of the IBC, 2016 in line with the UNCITRAL Legislative Guide on Insolvency Law, 2005 (Para 24, p. 46) to put the issue of discretion to rest."

> "24. One issue associated with the general cessation of payments test that needs to be considered is that the inability of the debtor to pay its debts as they become due may point only to a temporary cash flow or liquidity problem in a business that is otherwise viable. In today's competitive markets, competition may compel market participants to accept ever-lower profits or even losses on a temporary basis in order to become competitive and maintain or gain market share. While it will be a question of fact in each case, it is desirable that an insolvency law provide guidance for the court to determine whether or not the commencement standard has been met in order to avoid a premature finding of insolvency."

In conclusion, it is humbly submitted that necessary amendment to the Law would be in order to put the issue of discretion in admission to the CIRP in case of financial defaults, once and for all, lest the continued positive growth trajectory of the successful Code be stinted for the reasons discussed above.