Between the lines...

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Key Highlights

I. NCLT Hyderabad rejects Edelweiss ARC's objections, approves first resolution plan

The National Company Law Tribunal, Hyderabad Bench (the **"NCLT"**) in the matter of ***Synergies- Dooray Automotive Limited ("Synergies Dooray")*** and in the matter of ***Ms. Mamta Binani ("RP") vs. Edelweiss Asset Reconstruction Company Limited ("Edelweiss ARC") and Others*** approved the first insolvency resolution plan under the Insolvency and Bankruptcy Code, 2016 (the **"Code"**), on August 2, 2017.

Facts

Synergies Dooray, corporate debtor had filed application for initiating corporate insolvency resolution process which was admitted by the NCLT on January 23, 2017 and RP was appointed as an interim resolution professional. Thereafter, committee of creditors (the **"CoC"**) was constituted and RP was confirmed as the resolution professional. As required under the Code, RP invited prospective lenders, investors, and other persons to put forward their resolution plans. Three entities had sent their resolution plans, out of which resolution plan of Synergies Castings Limited (respondent number 3 in this case) (**"Respondent 3"**) was approved by a majority vote in the meeting of the CoC on June 24, 2017.

Under sub-section (6) of Section 30 of the Code, a resolution professional is required to submit the resolution plan as approved by the CoC to the NCLT for its approval. Therefore, RP submitted the plan before NCLT. Under sub-section (1) of Section 31 of the Code, if the NCLT is satisfied that the resolution plan satisfies certain requirements under the Code, it approves the resolution plan which becomes binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

It is pertinent to note here that three assignment agreements were alleged to have been executed immediately prior to the repeal of the Sick Industrial Companies (Special Provisions) Act, 1985 in November, 2016, through which, Respondent 3 had assigned ninety percent of its debt holding in Synergies Dooray to Millennium Finance Limited (respondent number 2 in this case) (**"Respondent 2"**). As per proviso to sub-section (2) of Section 21 of the Code, a related party to whom a corporate debtor owes a financial debt cannot have any right of representation, participation or voting in a meeting of the CoC. Respondent 3 was a related party of Synergies Dooray and therefore, was not entitled to a seat in the CoC. However, with assignment of debt holding by Respondent 3 to Respondent 2, Respondent 2 got a seat in the CoC with more than 75% voting share. As per the Code, the resolution plan is to be approved by a vote of not less than 75% of voting share of financial creditors.

Arguments

Edelweiss ARC prayed that the resolution plan should not be approved as it was in contravention of the provisions of the Code. It was also contended that for the assignment agreements executed to transfer debt holding, there was no flow of consideration from Respondent 2 to Respondent 3. The crux of Edelweiss ARC's submission was that the assignment agreements were questionable as they were executed to ensure a seat in the CoC through Respondent 2, which otherwise Respondent 3 was not entitled to as per the provisions of the Code (as stated above).

On the other hand, RP submitted that the resolution plan was in accordance with the provisions of the Code. It was further submitted that all the allegations of Edelweiss ARC were already rejected by the NCLT in separate cases.

Observations of the NCLT

The NCLT took note of certain features of the resolution plan such as:

i. Amalgamation of Respondent 3 with Synergies Dooray;

ii. Payment to all financial creditors of Synergies Dooray in equal instalments over a period of three years, without interest;

iii. Continued employment to all the erstwhile workmen of Synergies Dooray; and

iv. Reliefs/concessions envisaged in the plan.

The NCLT observed certain benefits of the plan like employment to all workers, amalgamation bringing financial and operational synergies, etc. and finally held that, *"……it would be in the best interest of the Company, its employees in particular, public in general, and also in the interest of financial creditors to accept the resolution plan in question. We are unanimous in accepting Resolution plan in question as it meets all parameters including legal and moral."*

Decision of the NCLT

The NCLT allowed the application, approving the resolution plan with certain conditions. Consequently, moratorium ceased to have effect.

VA View

This judgment of the NCLT which is the first insolvency resolution plan approved under the Code raises a lot of questions. It appears that the assignment agreements for transfer of debt holding were to ensure a seat on the CoC. The NBFC to which debt holding was transferred by the related party of corporate debtor got majority voting rights in the CoC. The allegations of Edelweiss ARC may not be incongruous as in such cases, it will be very easy for the corporate debtor to get a resolution plan in its favour.

However, the National Company Law Appellate Tribunal has now admitted appeal filed by Edelweiss ARC and final hearing is scheduled on October 11, 2017. Further, Edelweiss ARC has filed a complaint against the RP with the Insolvency and Bankruptcy Board of India for her alleged failure in, inter alia, investigating fraudulent transactions and deciding related party issues. It will be interesting to see the outcome of the appeal and stand of the Insolvency and Bankruptcy Board of India as to whether it will take any action against the RP.

II. Supreme Court's order in Jaypee Infratech case provides some relief to homebuyers

The Supreme Court of India (the **"SC"**) in the matter of ***Chitra Sharma and Others vs. Union of India and Others*** recently passed an order (dated September 11, 2017) revising its previous order (dated September 4, 2017) in which it had stayed the initiation of insolvency proceedings against Jaypee Infratech Limited **("Corporate Debtor")** passed in the matter of ***IDBI Bank Limited ("Financial Creditor") vs. Jaypee Infratech Limited*** by the National Company Law Tribunal, Allahabad Bench (the **"NCLT"**) (dated August 9, 2017).

Facts

The NCLT in the matter of ***IDBI Bank Limited vs. Jaypee Infratech Limited*** admitted the application for initiation of the Corporate Insolvency Resolution Process (**"CIRP"**) against the Corporate Debtor under Section 7 of the Insolvency and Bankruptcy Code, 2016 (the **"Code"**) due to the default in payment of a loan to the tune of INR 5.26 billion by the Corporate Debtor.

The Corporate Debtor filed its objection opposing the admission, but subsequently withdrew the same on August 4, 2017 and gave a no-objection considering the interest of all the shareholders including home buyers and depositors. It subsequently filed a formal memo to such effect, on the instruction of the NCLT.

The NCLT observed that, default had occurred which met the requirements of Section 3(11) & (12) of the Code which are as under:

"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; and

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."

The NCLT relied on the test laid down by the National Company Law Appellate Tribunal in the matter of ***M/s Innoventive Industries Ltd. vs. ICICI Bank & Anr.*** Company Appeal (AT)(Insolvency) No. 1 & 2 of 2017 under which the adjudicating authority has to satisfy following three conditions under Section 7(5) of the Code for admission:

1. Occurrence of default;
2. Application under Section 7 of the Code is complete; and
3. No disciplinary proceeding is pending against the proposed insolvency resolution professional.

The NCLT held that the petition had to be admitted under Section 7 of the Code. The NCLT admitted the application along with certain directions, which had seriously prejudiced the interest of the homebuyers.

Proceedings before the SC

Aggrieved by the order of the NCLT, the home buyers approached the SC wherein the court (by order dated September 4, 2017) addressed the grievances of the homebuyers and held that the order(s) passed by NCLT shall remain stayed until further orders. However, subsequently the SC (by order dated September 11, 2017) modified the order dated September 4, 2017and issued certain other directions.

Arguments before the SC

In the SC, the counsel for certain respondents submitted that the earlier order of the court should be modified because the consequence of the stay would be that the management of Corporate Debtor would stand restored. If the erstwhile management continued, it shall affect the rights of the creditors and the consumers as well. It was also submitted by the counsel on behalf of certain respondents that some time should be granted to the Interim Resolution Professional (**"IRP"**) to formulate at least a preliminary scheme so that the interest of all stakeholders is protected. The counsel for Financial Creditor submitted that under the statutory scheme, the IRP has to take over the management of Corporate Debtor, otherwise the letter and spirit of the Code is likely to be affected.

The petitioners (home buyers) submitted that if the IRP is restored, then there should be a representative from the home buyers or the court may appoint someone on the committee of creditors to espouse the interests of the home buyers.

Observations and decision of the SC

The SC directed the IRP to take over the management of the Corporate Debtor with a direction that it shall formulate and submit an interim resolution plan within 45 days before the SC. The interim resolution plan shall make all necessary provisions to protect the interests of the home buyers. It also ordered that all suits and proceedings instituted against the Corporate Debtor shall in terms of Section 14(1)(a) of the Code remain stayed as the SC has directed the IRP to remain in management. It further appointed two persons to participate in the meetings of the committee of creditors under Section 21 of the Code to espouse the cause of the home buyers and protect their interests.

The SC restricted the Managing Director and the Directors of the Corporate Debtor and Jaiprakash Associates Limited, the holding company of the Corporate Debtor (**"JAL"**), from leaving India without its prior permission. JAL which was not a party to the insolvency proceedings, was directed to deposit a sum of INR 20 billion before October 27, 2017. The matter has been listed for further hearing on November 13, 2017.

VA View

The position of the homebuyers as a class/category of creditors still needs some clarifications. This is something which cannot be decided arbitrarily, and in the absence of any concrete guidelines on the same, it will lead to the failure of the institutional mechanism as prescribed in the Code. This order is only an interim relief for the homebuyers and it needs to be seen as to what would be the final outcome of the case when the proceedings are concluded before the apex court.

III. NCLAT decides on whether Limitation Act is applicable to Insolvency and Bankruptcy Code, Supreme Court keeps the question open

The National Company Law Appellate Tribunal (the **"NCLAT"**) in the case of ***Neelkanth Township and Construction Private Limited vs. Urban Infrastructure Trustees Limited*** (decided on August 11, 2017) has held that Limitation Act, 1963 (the **"Limitation Act"**) is not applicable to the Insolvency and Bankruptcy Code, 2016 (the **"Code")**. The NCLAT has also made other important observations in this judgment.

Facts

Part II, Chapter II of the Code provides for Corporate Insolvency Resolution Process (**"CIRP"**). Section 6 of the Code under this Chapter provides that a financial creditor, operational creditor or the corporate debtor itself can initiate CIRP as per procedure prescribed by the Code.

In the present case, the Respondent was a financial creditor who had filed an application under Section 7 of the Code before the National Company Law Tribunal, Mumbai Bench (the **"NCLT"**). Section 7 of the Code allows a financial creditor or a group of financial creditors to file application for initiating CIRP against the corporate debtor when default occurs. The NCLT by its order dated April 21, 2017, had admitted the application filed by the Respondent for initiating CIRP against the corporate debtor (Appellant in this case). The Appellant challenged this order of the NCLT in the NCLAT.

Arguments

The counsel for the Appellant submitted that it was the duty of the Insolvency and Bankruptcy Board of India (**"IBBI"**) to prescribe regulations for record or evidence of default and in absence of the same, the proceedings under Section 7 of the Code could not be initiated. Clause (a) of sub-section (3) of Section 7 of the Code reads as under:

*"**7…… (3)** The financial creditor shall, along with the application furnish—*

***(a)** record of the default recorded with the information utility or such other record or evidence of default as may be specified;"*

Thus, sub-section (3) of Section 7 of the Code requires a financial creditor to submit certain documents alongwith the application such as record of default recorded with information utility or such other record or evidence of default as may be specified, the name of the resolution professional proposed to act as interim resolution professional et cetera. Under Section 7 (4) of the Code, the NCLT ascertains the existence of default from the records of an information utility or on the basis of other evidence furnished by the financial creditor. Before admitting the application, the NCLT should be satisfied that, inter alia, default has occurred and the application is complete.

The Appellant further challenged the NCLT order on the ground that the Respondent was an investor, not a "financial creditor" as defined under the Code. The Code only permits persons falling under the definition of "financial creditor", "operational creditor" or "corporate debtor" to file an application to initiate the CIRP.

One of the important arguments of the Appellant was that the application was time barred as it was contended, *"The claim of the 'Financial Creditor', is completely time barred as the debenture certificates were due for redemption as far back as in the years 2011, 2012 and 2013 respectively. Consequently, the application filed by the 'Financial Creditor' in the year 2017 is hopelessly time barred."* The Appellant also brought to the notice of the NCLAT, the pendency of arbitral proceedings between the parties.

The counsel for the Respondent contended that the NCLT had taken note of the balance sheet of the Appellant while allowing the application of the Respondent.

Observations of the NCLAT

The NCLAT first answered the question as to whether in absence of record of default as recorded with the information utility or any other record or evidence of default, an application under Section 7 of the Code is maintainable or not. The NCLAT rejected the argument of the Appellant that IBBI had not made regulations with respect to record or evidence of default. The NCLAT noted the contents of Form 1 under the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (the **"AA Rules"**). To elaborate, the financial creditor makes an application before the NCLT to initiate CIRP in Form-1 under the AA Rules. Form 1 is divided into various parts containing particulars of information to be provided by the financial creditor such as particulars of each financial creditor making the application, particulars of the corporate debtor, particulars of the proposed interim resolution professional and details of financial debt alongwith documents, records and evidence of default to be attached with Form 1/application. Thus, the NCLAT held that Part V of Form -1 of the AA Rules will hold good to decide the default of debt for the purpose of Section 7 of the Code.

The NCLAT further noted the contents of Form C (proof of claim by financial creditors) under the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**"Process for Corporate Persons Regulations"**) which requires documents to be attached in order to prove the default. Thus NCLAT held that under Serial No. 10 of the Form C of Process for Corporate Persons Regulations, the financial creditor is supposed to refer the list of documents in proof of claim in order to prove the existence and non-payment of claim dues to the operational creditor.

With respect to the issue of limitation, the NCLAT observed that there was no provision in the Code which suggested that the Limitation Act was applicable to the Code. The NCLAT held, *"The I& B Code, 2016 is not an Act for recovery of money claim, it relates to initiation of Corporate Insolvency Resolution Process. If there is a debt which includes interest and there is default of debt and having continuous course of action, the argument that the claim of money by Respondent is barred by Limitation cannot be accepted."*

On the issue whether the Respondent came within the meaning of "financial creditor" under the Code, the NCLAT was of the view that debentures were within the meaning of "financial debt" as defined in the Code and consequently, the Respondent was held to be a "financial creditor".

Decision of the NCLAT

The NCLAT dismissed the appeal observing that no interference was required with the decision of the NCLT.

VA View

This decision of the NCLAT does not appear to be sound. We would like to bring to our readers' attention the existing provision under Section 433 of the Companies Act, 2013, which provides, *"The provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal, as the case may be."* The NCLAT seems to have bypassed this provision without consideration.

The decision of NCLAT has also failed to consider the case of ***Sanjay Bagrodia vs. Sathyam Green Power Private Limited*** (National Company Law Tribunal, Principal Bench, New Delhi; decided on May 25, 2017) where it was noted that the Limitation Act does apply to the Code. Interestingly, it was observed in this case, *"Then we ask learned Counsel for the Applicant whether an application under IBC would be maintainable to recover the amount which fell due 50 years ago. Mr. Mehta, learned Counsel for the Applicant lowered his eyes and was not able to propose any straight answer. We are thus of the considered view that this Tribunal cannot be a flowering pot for claims which have become dead and are wholly time barred."*

Recently on August 23, 2017, the apex court has dismissed the appeal in the instant matter and chose to keep the question of law regarding the applicability of the Limitation Act open.

Other noteworthy feature of this judgment is that the provisions as existing now with respect to evidence of default are sufficient for proving the existence of default and as pointed out by the NCLAT, there are rules and regulations framed in this regard by IBBI. Therefore, this cannot come in the way of an application for initiating CIRP under the Code.

IV. Consolidated FDI Policy Circular of 2017 released

The Consolidated FDI Policy Circular of 2017 (**"2017 Policy"**) was released on August 28, 2017 by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India (**"DIPP"**), effective from the same date.

DIPP issues consolidated policy every year and changes are brought in the consolidated policy during the year through press notes. 2017 Policy compiles the Consolidated FDI Policy Circular of 2016 (**"2016 Policy"**) and the press notes issued thereafter amending the 2016 Policy.

Some important changes introduced by 2017 Policy are summarised below:

- **Foreign direct investment ("FDI") in single brand product retail trading and cash & carry wholesale trading:**

Press Note 5 issued by DIPP on June 24, 2016 had provided that sourcing norms will not be applicable up to three years from commencement of the business, that is, opening of the first store for entities undertaking single brand retail trading of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible.

2017 Policy further provides that a committee will now examine the claim of applicants on the issue of the products being in the nature of 'state-of-art' and 'cutting-edge' technology where local sourcing is not possible and give recommendations for such relaxation. This committee will be chaired by Secretary, DIPP, with representatives from NITI Aayog, concerned administrative ministry and independent technical expert(s) on the subject.

Under paragraph 5.2.15.1.2 (f) of 2016 Policy, it is stated that a wholesale/cash & carry trader can undertake single brand retail trading, subject to the conditions mentioned in para 5.2.15.3 (on single brand product retail trading). 2017 Policy introduces a change and now wholesale/cash & carry trader can undertake retail trading and not just single brand retail trading. The term "singe brand" is deleted, meaning that multi brand retail trading can also be undertaken subject to the conditions as applicable.

- **Downstream investments:**

Under paragraph 3.8.4.2 (i) of 2016 Policy, downstream investment intimation was required to be given to the Secretariat of Industrial Assistance, DIPP and Foreign Investment Promotion Board. In a significant change, under paragraph 3.8.4.2 (i) of 2017 Policy, intimation of downstream investment is now to be given to the Reserve Bank of India and Foreign Investment Facilitation Portal.

- **FDI in LLPs:**

Under paragraph 3.2.4 (i) of 2016 Policy, FDI is allowed in limited liability partnership (**"LLP"**) under the automatic route, if:

– LLP is operating in sectors/activities where 100% FDI is allowed, through the automatic route; and

– there are no FDI-linked performance conditions.

Under paragraph 3.2.4 (ii) of 2016 Policy, an Indian company or LLP, having foreign investment, is also permitted to make downstream investment in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions.

However, it was difficult to decipher the 'FDI-linked performance conditions' in the absence of any definition of the same in 2016 Policy. Paragraph 2.1.15 of 2017 Policy now defines 'FDI-linked performance conditions' as the sector specific conditions for companies receiving foreign investment.

Further, newly inserted paragraph 3.2.4(iii) of 2017 Policy provides for conversion of LLP into a company and vice-versa. It is provided that conversion of LLP having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into a company is permitted under automatic route. Similarly, conversion of a company having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into LLP is permitted under automatic route.

- **Cases which do not require fresh approval:**

Under paragraph 4.2.1(iv) of 2016 Policy, fresh approval was not required for additional foreign investment into the same entity within an approved foreign equity percentage/or into a wholly owned subsidiary. 2017 Policy has brought a change and now fresh approval will not be required only in cases where such additional foreign investment is up to cumulative amount of INR 50 billion. This means that if such additional investment goes beyond this prescribed threshold, approval will have to be sought.

VA View

2017 Policy has introduced certain significant changes to the FDI policy regime. A major change is the intimation of downstream investment to the Reserve Bank of India which may result in inquiries by the Reserve Bank. However, to what extent the country's apex bank will examine such investments remains to be seen.

Another significant change is the insertion of definition of "FDI-linked performance conditions" which was a gap in the FDI policy as in the absence of definition, there were varied interpretations taken by the stakeholders.

In relation to the abolishment of Foreign Investment Promotion Board, 2017 Policy does reflect the necessary changes in the approval regime as it provides a list of administrative ministries/ departments which are competent authorities for granting approval for each sector. However, detailed procedures which were introduced by the Standard Operating Procedure (SOP) for processing FDI proposals dated June 29, 2017 issued by DIPP are not incorporated in 2017 Policy. Thus, SOP will continue to be referred for this purpose (as stated in 2017 Policy itself) as all the SOP provisions are not consolidated in 2017 Policy.

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