Between the lines...

March, 2020

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Key Highlights

I. Supreme Court: Ambit for adjudication of preferential transactions defined

The Supreme Court in its judgement dated February 26, 2020, in the case of ***Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Limited,*** has clarified several issues including the scope and ambit for adjudication of preferential transactions, and the nature of financial debt particularly in relation to third-party mortgages amongst others.

Facts

This matter reached the Supreme Court by an appeal against an order dated August 01, 2018 passed by the National Company Law Appellate Tribunal regarding an application moved by the Interim Resolution Professional (**"IRP"**) of Jaypee Infratech Limited (**"JIL"**) seeking avoidance of certain transactions, whereby the corporate debtor (JIL) had mortgaged its properties as collateral securities for the loans and advances made by the lender banks and financial institutions to Jaiprakash Associates Limited (**"JAL"**), the holding company of JIL, as being preferential, undervalued and fraudulent, in terms of Sections 43, 45 and 66 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**). The contention of IRP, that the transactions in question were preferential, undervalued and fraudulent within the meaning of Sections 43, 45 and 66 of the IBC, were accepted in part by the NCLT, in its order dated May 16, 2018 and directions were issued for avoidance of at least six of such transactions. The transactions in question essentially create security for loans advanced to JAL from the assets (immovable property) belonging to JIL. The National Company Law Appellate Tribunal (**"NCLAT"**), however, took an entirely opposite view of the matter and upturned the order passed by NCLT.

Another issue was if the lenders of the JAL could be recognised as lenders of JIL for the purposes of the IBC on the strength of the mortgage created by JIL, as collateral security of the debt of its holding company, JAL. It is pertinent to

note that the Committee of Creditors (**"CoC"**) was required by the Supreme Court to be reconstituted in view of the directions in ***Chitra Sharma v. Union of India*** *(decided on November 06, 2019),* and the subsequent amendments brought about in the IBC which allowed homebuyers to be part of the CoC of both JAL and JIL. This issue was raised by ICICI Bank Limited and Axis Bank Limited, which challenged the decision of the IRP of rejecting their claims to be recognized as financial creditors of JIL on account of the securities provided by JIL for the facilities granted by them to JAL.

Issues

Broadly, the following issues were discussed by the Supreme Court:

(i) Whether impugned transactions are preferential, falling within Section 43(2) of the IBC. In order to better understand the issue, it can be further categorised in the following manner:

   a. Extent of the look back period in terms of Section 43(4) of the IBC.

   b. Meaning and scope of ordinary course of business or financial affairs.

   c. Duties and responsibilities of resolution professional in CIRP as per Section 25 with respect to Section 43 of the IBC.

(ii) Whether lenders of JAL could be categorised as financial creditors of JIL.

Arguments

Issue (i):

Regarding the issue pertaining to the avoidance application, the counsel for the IRP argued that transactions have the effect of putting JAL, which is an equity shareholder and an operational creditor (for an amount of INR 261.77 crores) of JIL, in a beneficial position than it would have been in the event of distribution of assets under Section 53 (liquidation waterfall) of the IBC vis-à-vis other creditors; and that if the transactions are held to be valid, the liability of JAL towards its own creditors gets secured and becomes realisable from the value of the mortgaged properties whereby, JAL's liabilities are reduced and JAL gets benefitted in exclusion of creditors of JIL.

It was further contended that the assets in question were released from the earlier mortgages and fresh mortgages were created during the look back period with increased/enhanced amount of facilities as provided under each individual transaction. The said so-called re-mortgage essentially amounts to a fresh mortgage within the relevant time of two years before the date of commencement of CIRP and was not done in the ordinary course of business of JIL and hence, is hit by Section 43 of the IBC.

It was further argued that Section 43 of the IBC ought to be read keeping in mind the intention of the legislature in introducing such provision, which had been to protect the creditors against siphoning away of corporate assets by the management of the company, who have special knowledge of the company's financial troubles by virtue of its position, and that the true economic effect of the transaction must be put under the scanner.

Ordinary Course of Business:

Further, it was contended that mortgages could not have been made in the "ordinary course of business" of JIL, as it is difficult to fathom why a subsidiary would furnish security to its parent company in the ordinary course and, on the contrary, it is the parent company which at times furnishes security on behalf of its subsidiary since it derives economic value from the subsidiary. Since JIL was itself reeling under financial stress, why it would routinely undertake to secure the indebtedness of JAL by furnishing such high valued securities and that too when the amount of debt secured by way of mortgaging the assets of the corporate debtor increased from INR 3,000 crores to approximately INR 24,000 crores. Even though creation of third party security is a normal practice, the creation of every third party security cannot always deemed to have been done in the ordinary course of business; that such 'ordinary course' has to be determined under the circumstances when such transactions were entered into.

Relevant Period/ Lookback Period:

It was contended that the term 'transaction' under the IBC includes an agreement or arrangement in writing for the transfer of assets, or funds, goods or services from or to the corporate debtor. The use of the word 'include' would signify its natural import and is to be given a wide interpretation.

The respondents, particularly the lenders of JAL stated that the transactions in question are not preferential and do not fall under Section 43 of the IBC and submitted that they, being bankers and financial institutions, are regularly engaged in the business of extending loans and other facilities which form the backbone of economic growth, since Section 43(3)(a) carves out exception for the transactions made in the ordinary course of business. It was stated that taking of such securities, including third party security, is one of the normal and ordinary features of their business and dealings, particularly that of corporate money lending. They stated that if at all such third party securities are avoided on the allegation of being preferential, it is likely to have a devastating effect on the entire economy because the bankers and financial institutions would then be left high and dry and for future dealings, they shall have no alternative but to restrict their activities only to the direct party securities which would, in turn, result in retardation and regression.

A creditor of JAL, Axis Bank, further contended that the land parcels were mortgaged on February 24, 2015, which is beyond even the two years formulation, the relevant time being from August 10, 2015 to August 09, 2017 as the lookback period for related party transactions is two years. The subsequent re-execution of the mortgage deeds on September 15, 2015 and then again on December 29, 2016 cannot be considered a substantive event since the nature and identity of the security remained the same and no fresh encumbrances were created and the same was done merely to reflect the increase in the facilities and members of the consortium.

Standard Chartered Bank, another creditor of JAL, argued in furtherance of the arguments earlier advanced regarding the fact that the transactions were made in the ordinary course of business by pointing out that in the annual reports of JIL the mortgaged properties were disclosed as 'inventories' for the corporate debtor being a real estate company; and hence, dealing with the 'inventories'/'stock-in-trade' is in the ordinary course of business. It

was also argued that for the purpose of Section 43 of the IBC, the relationship between the respondent-lenders and JIL ought to be looked into rather than assuming JAL to be the primary transferee.

JAL, while pointing out previous transactions such as cash infusions, bank guarantees and pledges of shares by JAL on behalf of JIL demonstrated that transactions between the two entities were in their ordinary course of business and further argued that the mortgage of land in favour of the lenders of JAL was authorised in the manner provided in Section 186 of the Companies Act, 2013.

Issue (ii):

The central question was if the lenders of JAL could be recognised as financial creditors of JIL for the purposes of the IBC. It was pointed out that in the present case, the corporate debtor has created a mortgage of its property in favour of third party without any consideration for time value of money, therefore, the basic ingredient of 'financial debt' was not made, since the lenders of JAL having not disbursed any debt against the consideration for the time value of money to JIL, thus, there is no money owed by JIL to the lenders. It was also argued that holding security interest would not automatically make an entity a financial creditor, and that 'mortgage' was not covered under the definition of financial debt under the IBC.

The lenders of JAL argued that the nature and character of a 'mortgage' is such that it secures a debt; and in the present case, the mortgage in question, as made by JIL, had been to secure the debt obligations of its holding company, JAL. The learned counsel has also referred to an order in the case of ***SREI Infrastructure Finance Limited v. Sterling International Enterprises Limited,*** *(decided on March 13, 2019),* wherein it is held that a third party mortgagor, who mortgages the property to secure the financial obligation of another party, stands in the position of a guarantor; and the mortgagee is a financial creditor of the third party mortgagor. It was further argued that as per the mortgage deeds/loan documents entered into between the parties, JIL had unequivocally promised to pay to the debts/liabilities owed by JAL in accordance with the terms and conditions of the secured financing documents executed.

Observations of the Supreme Court

The Supreme Court first analysed the historical background, objects, scheme and structure of the relevant parts of the IBC, after which it proceeded to address the issues framed by it.

Issue (i):

It was observed that there has been no creditor-debtor relationship between the lender banks and JIL, but that will not be decisive of the question of the ultimate beneficiary of these transactions. The mortgage deeds in question, entered by JIL to secure the debts of JAL, amount to creation of security interest to the benefit of JAL. It was also held that the transactions put JAL in such capacity that it is a related party to JIL and is a creditor as also surety of JIL. In other words, JIL owed antecedent financial debts as also operational debts and other liabilities towards JAL therefore, the requirement of Section 43(2)(a) was met. Further, it was observed that JAL, as an operational creditor

would not be given priority in repayment as per the liquidation waterfall provided for in Section 53 of the IBC. Therefore, it was observed that the requirement under Section 43(2)(b) was met. Thus, it was concluded that JIL has given a preference in the manner laid down in Section 43(2) of the IBC.

With regard to the lookback period, it was held that the argument of the respondents that the impugned transactions were not of creation of any new encumbrance by JIL and in fact, most of the properties in question had already been under mortgage with the respective lenders much before the lookback period commenced and that the re-mortgages could not be counted as separate 'transactions', cannot be accepted. It was held that so-called re-mortgage, on all its legal effects and connotations, could only be regarded as a fresh mortgage.

With regard to whether the transactions were made in the ordinary course of business affairs, it was observed that Section 43(a)(3) of the IBC calls for purposive interpretation so as to ensure that the provision operates in sync with the intention of legislature and achieves the avowed objectives therefore, the word 'or' should be read as 'and', thus, the provision should read as; '*transfer made in the ordinary course of the business or financial affairs of the corporate debtor and the transferee'.*

It was observed that an activity could be regarded as 'business' if there is a course of dealings, which are either actually continued or contemplated to be continued with a profit motive. Therefore, even if transferees submit that such transfers had been in the ordinary course of their business, the question would still remain if the transfers were made in the ordinary course of business or financial affairs of JIL so as to fall within the exception provided in the IBC. The decision of the High Court of Australia in the case of ***Downs Distributing Company Pty Limited v. Associated Blue Star Stores Pty Limited (in liq.)*** *((1948) 76 CLR 463)* was referred to, where it was held that ordinary course of business would mean: *"that the transaction must fall into place as part of the undistinguished common flow of business done, that it should form part of the ordinary course of business as carried on, calling for no remark and arising out of no special or particular situation."*

The Supreme Court therefore, held that even if the transactions in question were entered in the ordinary course of business of bankers and financial institutions like the present respondents but on the given set of facts, there is not an iota of doubt that the impugned transactions do not fall within the ordinary course of business of JIL, which had been promoter as a special purpose vehicle floated by JAL for the purpose of construction and operation of Yamuna Expressway and for development of the parcels of land along with the expressway for residential, commercial and other uses. Therefore, the Supreme Court concluded that providing mortgages to secure the loans of JAL, at the cost of its own financial health could not be construed to be in the 'ordinary course of business of JIL.

It was further held that since the lenders, as a part of their due diligence are required to study the viability of the enterprise that it is lending to in order to ensure, *inter alia,* that the security against such loan/advance/facility is genuine and adequate and that the lenders should have assessed if the security provided to them was prudent and viable. It was also observed that since several of the lenders of JIL were also lenders of JAL, they could not plead ignorance about the financial position of either party and should have been aware of the risk involved.

After holding that the transactions were hit by Section 43 of the IBC, the Supreme Court further went on to express how it expected resolution professionals to apply the provisions.

Issue (ii):

Firstly, the determination of Issue (i) was reiterated, and it was held that the security interests created by JIL over the properties in question stand discharged in whole. However, the Supreme Court saw it fit to answer the question raised on basis of the law in order to create a lasting precedent. It was observed that the IBC confers upon financial creditors with a pivotal role in the corporate insolvency resolution process due to the fact that financial creditors are, from the very beginning, involved in assessing the viability of the corporate debtor who can, and indeed, engage in restructuring of the loan as well as reorganisation of the corporate debtor's business when there is financial stress.

The Supreme Court further went on to hold that there was not an iota of doubt that for a debt to become 'financial debt' for the purpose of Part II of the IBC, the basic element is that it ought to be a disbursal against the consideration for time value of money and that for a person to be designated as a financial creditor of a corporate debtor, it has to be shown that the corporate debtor owes a financial debt to such person. Understood this way, it becomes clear that a third party to whom the corporate debtor does not owe a financial debt cannot become its financial creditor for the purpose of Part II of the IBC.

It was further observed that the position and role of a person having only security interest over the assets of the corporate debtor could easily be contrasted with the role of a financial creditor because the former shall have only the interest of realising the value of its security (there being no other stakes involved and least any stake in the corporate debtor's growth or equitable liquidation) while the latter, apart from looking at safeguards of its own interests, would also simultaneously be interested in rejuvenation, revival and growth of the corporate debtor. Thus understood, it is clear that if the former, that is, a person having only security interest over the assets of the corporate debtor is also included as a financial creditor and thereby allowed to have its say in the processes contemplated by Part II of the IBC, the growth and revival of the corporate debtor may be the casualty.

Therefore, it was held that if a corporate debtor has given its property in mortgage to secure the debts of a third party, it may lead to a mortgage debt and, therefore, it may fall within the definition of 'debt' under Section 3(10) of the IBC. However, it would remain a debt alone and cannot partake the character of a 'financial debt' within the meaning of Section 5(8) of the IBC. Thus, it was concluded that the lenders of JAL, on the strength of the mortgages in question, may fall in the category of secured creditors, but such mortgages being neither towards any loan, facility or advance to the corporate debtor nor towards protecting any facility or security of the corporate debtor, it cannot be said that the corporate debtor owes them any 'financial debt' within the meaning of Section 5(8) of the IBC; and hence, such lenders of JAL do not fall in the category of the 'financial creditors' of JIL.

Decision of the Supreme Court

The Supreme Court held that the transactions were hit by Section 43 *(preferential transactions and relevant time)* of the IBC, and the NCLT had correctly passed directions as per Section 44 *(orders in case of preferential transactions)* of the IBC.

VA View

This landmark judgement of the Supreme Court cleared the air on many issues. Firstly, it was elucidated by the Supreme Court as to what actually was a preferential transaction and further, it laid down the steps that should be taken by a resolution professional in order to determine the same. It clarified the law with regard to the operation of the look back period under the IBC.

However, the status of third party mortgagees has not been clarified except for stating that they will not be reckoned as 'financial creditors' which means they would not be a part of the committee of creditors and would not be able to vote on issues. This has essentially created a new class of creditors, namely creditors to other entities such as sister concerns/ subsidiaries/ holding companies.

It was also observed that such lenders should be conducting thorough due diligence and analysis with regard to the entity which is actually providing the security and to determine if the security so provided is prudent and viable. Further, by an extension of the reasoning provided herein, other securities provided on behalf of third parties, which is a common occurrence in India, would not constitute 'financial debt' in relation to a corporate debtor.

II. SAT: IRDAI's order that 'transfer/pledge of shares' of an insurance company was in violation of the provisions of the Insurance Act, 1938 and hence 'null and void ab initio', set aside

The Securities Appellate Tribunal by way of its order dated February 27, 2020 has set aside the orders passed by the Insurance Regulatory and Development Authority of India (**"IRDAI"**) *(passed on December 4, 2019 and December 27, 2019)* wherein, it was held that invocation of pledge in respect of the shares of Reliance General Insurance Company Limited was null and void ab initio.

Facts

Appellant no.1, Nippon India Mutual Fund (**"NIMF"**) is a trust established under the Indian Trust Act, 1882. Whereas appellant no. 2, Nippon Life India Asset Management Limited (**"Nippon AMC"**) is an asset management company registered with the Securities and Exchange Board of India (**"SEBI"**). The respondent no.1 is the IRDAI. Respondent no.2, that is, IDBI Trusteeship Services Limited (**"IDBI Trusteeship"**) was appointed as debenture trustee in respect of non-convertible debentures (**"NCDs"**) issued by Reliance Home Finance Limited (**"RHFL"**). The appointment of IDBI Trusteeship as debenture trustee was made by way of a debenture trust deed dated January 10, 2018, entered into between IDBI Trusteeship and RHFL.

An information memorandum dated March 28, 2018 had been issued by RHFL for private placement of its 8000 NCDs aggregating to an amount of INR 400 crores. Nippon AMC subscribed to all 8000 NCDs at the time and is presently holding 6369 NCDs. However, RHFL was unable to redeem the NCDs on June 28, 2019 which was the maturity date, upon which, RHFL requested NIMF (one of the NCD holders) to restructure the terms of the NCDs and enable extension of the date of maturity from June 28, 2019 to October 31, 2019 (**"Revised Maturity Date"**).

The revision of the maturity date was agreed upon RHFL offering following additional securities: irrevocable and unconditional corporate guarantee offered by respondent no. 3, that is, Reliance Capital Limited (**"Reliance Capital"**), a promoter of RHFL; granting of put option right to the NCD holders, which required Reliance Capital to purchase NCDs in the event that the NCD holders were to exercise the put option; pledge by Reliance Capital in favour of IDBI Trusteeship over its entire shareholding in respondent no. 4, that is, Reliance General Insurance Company Limited (**"RGICL"**). RGICL, a subsidiary of Reliance Capital is in the business of general insurance. Pursuant to the aforesaid, a Guarantee Deed dated July 19, 2019 (**"Guarantee Deed"**) and a Share Pledge Arrangement dated June 26, 2019 (**"SPA"**) was executed by Reliance Capital whereby it pledged 100% of its shareholding which is RGICL shares (**"RGICL Equity Shares"**) in favour of IDBI Trusteeship. NIMF exercised its put option before the Revised Maturity Date, in order to sell 6369 NCDs. In that respect, NIMF issued a notice dated October 11, 2019, to Reliance Capital requiring purchase by the latter of the NCDs as per terms of the Guarantee Deed. However, when Reliance Capital failed to purchase the NCDs, NIMF wrote to IDBI Trusteeship seeking invocation of the pledged RGICL Equity Shares as per the terms of the SPA.

In pursuance thereto, IDBI Trusteeship issued notices dated October 18, 2019 and October, 24, 2019, to Reliance Capital, thereby invoking the pledge in respect of the RGICL Equity Shares. Thereafter, both IRDAI and the stock exchange were informed of the invocation of the said shares. However, the IRDAI by its order dated December 04, 2019 held that the aforementioned transfer of RGICL Equity Shares was null and void ab initio. Thereafter, an appeal had been filed before the Securities Appellate Tribunal, Mumbai (**"SAT"**) against the orders dated December 04, 2019 and December 27, 2019 (**"Impugned Orders"**).

By way of the Impugned Orders, IRDAI had held that the 'transfer of shares' made by IDBI Trusteeship, was in violation of Section 6A(4)(b)(iii) of the Insurance Act, 1938 (**"Insurance Act"**) which deals with approval of IRDAI in respect of registration of transfer of shares by public company carrying on life insurance business, general and health insurance business and re-insurance business, read with Regulation 3 *(registration of transfer)* of the IRDAI *(Transfer of Equity Shares of Insurance Companies)* Regulations, 2015 (**"Transfer Regulations"**). The IRDAI held that the aforementioned transfer of shares had been made by IDBI Trusteeship without the previous approval of the IRDAI and that such transfer, was void *ab initio.* By the order dated December 27, 2019, the IRDAI had reiterated its directions contained within the order dated December 04, 2019.

Further, by way of order dated December 27, 2019, the IRDAI additionally provided that such manner of transfer/pledge as aforesaid should not be given effect to, and that Nippon AMC and NIMF (collectively, **"Appellants"**) should exercise due diligence. An intervention application filed on behalf of Credit Suisse AG *(one of*

the parties seeking enforcement of the SPA), was allowed in the interest of justice. The IRDAI had also held that the transfer had violated foreign direct investment regulations. Pertinently because both Credit Suisse AG and NIMF were foreign entities and foreign holding for an insurance company is capped at 49%.

Issue

Whether transfer/pledge of RGICL Equity Shares was in violation of Section 6A(4)(b)(iii) of the Insurance Act read with Regulation 3 of the Transfer Regulations.

Arguments

The Appellants contended that pursuant to the order dated December 04, 2019, by a representation dated December 12, 2019, they had informed the IRDAI that IDBI Trusteeship had only complied with its statutory duty by invoking the SPA and taking possession of RGICL Equity Shares.

IRDAI was also intimated by the Appellants that before finding a buyer and selling the RGICL Equity Shares, IDBI Trusteeship would make a formal application to the IRDAI. It was also contended that neither NIMF nor IDBI Trusteeship exercised any control over RGICL. Further, they also did not intend to exercise any control, make any changes or have a say in the management or the decision making process or exercise any voting rights in respect of RGICL. It was also contended that Nippon AMC was an asset management company which was carrying out its business activities as per Regulation 24 *(restrictions on business activities of the asset management company)* of the SEBI (Mutual Funds) Regulations, 1996.

IDBI Trusteeship pointed out that the RGICL Equity Shares were being held by it in a dematerialised account, only in its capacity as a debenture trustee and that the said shares had not been transferred to it. To that effect, an affidavit had also been filed by IDBI Trusteeship before SAT wherein, it provided an undertaking that prior to the transfer of the RGICL Equity Shares by way of sale, it would seek approval of the IRDAI.

Observations of the SAT

The SAT observed that the letter dated February 04, 2020 issued by the IRDAI (in response to being intimated by NIMF communication in respect of invocation of RGICL Equity Shares), had noted that the RGICL Equity Shares were being held by IDBI Trusteeship only in its capacity as a trustee. As such, the said shares had not been transferred to it. The aforesaid letter also advised the Appellants that as and when transfer of the said shares were being contemplated, Section 6A(4)(b)(iii) of the Insurance Act read with Regulation 3 of the Transfer Regulations would have to be complied with.

SAT noted that the aforesaid letter to the Appellants and the reply filed by IRDAI before the SAT were only damage control measures adopted subsequently to the Impugned Orders. Further, the stand taken by the IRDAI in their reply had only resulted in dilution of the Impugned Orders. Moreover, it was clear from the said reply that prior to transfer of the RGICL Equity Shares, the IRDAI was required to be in a position to carry out due diligence to ascertain: (i) fulfilment of the 'fit and proper' criteria; and (ii) the financial soundness of the transferee.

Decision of the SAT

The SAT noted that the contention of the IRDAI that the word 'transfer' under Section 6A(4)(b)(iii) of the Insurance Act would also include a transfer of shares including a pledge, would not be considered at the present stage. The SAT however, held that the direction in the Impugned Orders passed by the IRDAI, that the transfer/pledge of the RGICL Equity Shares was null and void ab initio was incorrect, and accordingly the Impugned Orders were set aside. It was also recorded by SAT that IDBI Trusteeship was holding the RGICL Equity Shares as a custodian and that it was to make endeavours to find a suitable buyer in respect of the said shares.

The SAT further held that when a suitable buyer would be found, an application would be made before the IRDAI to enable it to carry out due diligence and, *inter alia,* ascertain fulfilment of the fit and proper criteria. It was also clarified by the SAT that so long as the RGICL Equity Shares were held by IDBI Trusteeship in its capacity as a debenture trustee/custodian, it will not be able to exercise any control or make changes or have a say in the management or decision making process or exercise any voting rights in respect of the RGICL Equity Shares.

VA View

The SAT did not consider if the word 'transfer' under section 6A(4)(b)(iii) of the Insurance Act would also include a transfer of shares including a pledge, and if one should seek approval from IRDAI at the time of, for example, pledging of RGICL Equity Shares.

However, it is pertinent to note that the SAT did in fact draw a conclusion that as and when a suitable buyer for the RGICL Equity Shares was in fact found, an application would have to be made before the IRDAI. This makes it amply clear that as and when the shares are to be transferred, ultimately, IRDAI Approval would have to be sought.

Further, it would be interesting to note that as per latest news reports, Vistra ITCL (formerly known as IL&FS Trust Company) has approached the Bombay High Court, in its capacity as the trustee of the secured redeemable non-convertible debentures issued by Reliance Capital. Claiming a charge on the RGICL Equity Shares in lieu thereof, Vistra ITCL has sought to prevent NIMF, Nippon AMC and IDBI Trusteeship from dealing with the said shares.

The decision of the Bombay High Court, could possibly queer the pitch for one of the parties' in respect of finally dealing with the RGICL Equity Shares.

III. National Company Law Appellate Tribunal, New Delhi: Corporate Insolvency Resolution Process against a real estate company is limited to the project concerned and will not affect other projects

The National Company Law Appellate Tribunal, New Delhi (**"NCLAT"**) has, by its order dated February 04, 2020 (**"Order"**), in the case of ***Flat Buyers Association Winter Hills – 77, Gurgaon v. Umang Realtech Private Limited through IRP and Others,*** held that a Corporate Insolvency Resolution Process (**"CIRP"**) against a real estate company would have to be limited to only the concerned project and will not affect other projects undertaken by it.

Facts

Mrs. Rachna Singh and Mr. Ajay Singh (**"Financial Creditors"**), allottees of an apartment in Winter Hills - 77 Gurgaon Project (**"Project"**) had moved an application under Section 7 *(initiation of CIRP by financial creditor)* of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) for initiation of CIRP against M/s. Umang Realtech Private Limited, a real estate company (**"Respondent"**), before the National Company Law Tribunal, New Delhi (**"Tribunal"**). Under an order dated August 20, 2019, the Tribunal admitted the said application and directed the Financial Creditors to deposit a sum of INR 2,00,000 with the Interim Resolution Professional (**"IRP"**) to meet the expenses of performing the functions assigned to him, including with respect to keeping the company a going concern. In the interim, the Flat Buyers Association of Winter Hills-77 Gurgaon (**"Appellant"**) filed the present appeal against the said impugned order dated August 20, 2019, on the ground that initiation of CIRP against the Respondent was causing hindrance to completion of the Project as the same was almost complete, and would be fully completed by October 2019.

Consequently, one of the promoters of the Respondent, Uppal Housing Private Limited (**"Uppal"**), agreed to remain outside the CIRP and play the role of a lender/ financial creditor to the Respondent to ensure that the allottees took possession of their flats/apartments in the Project during the CIRP without any third party (resolution applicant's) intervention. The Appellant accepted the aforesaid proposal and agreed to cooperate on the condition that it will receive 30 per cent of the amount paid by the allottees at the time of registration of their flat. In the meantime, the Financial Creditors, joined hands with the Appellant and became its members.

Issues

(i) Whether CIRP against a real estate company should be limited only to the concerned project or should other projects of the said real estate company be brought under the scope of such CIRP.

(ii) Whether a financial institution/bank (secured financial creditor) should be given preference over an allottee of flat/apartment (unsecured financial creditor) under a CIRP.

(iii) Whether a claim for refund by allottees can be allowed by the adjudicating authority.

Arguments

The Appellant, *inter alia,* contended that the construction of the flats in the Project was almost complete but the rights of other allottees were affected on account of the CIRP initiated by the Financial Creditors. Hence, the CIRP should be discontinued in the interest of all the allottees, towards ensuring survival of the Respondent, and focus should be directed towards completion of construction of the said flats.

The Respondent's primary contention was that the recovery proceedings against the Respondent should be stayed and the Respondent and/or Uppal should not be burdened with the obligation of paying any additional amounts with respect to satisfying the order(s) passed by any other court/consumer forum/ authority till the construction of the flats in the Project was completed. It was further contended that necessary directions be issued by the NCLAT to ensure that the amount deposited by the allottees, towards payment of their flats, be utilized exclusively for the purpose of providing amenities, facilities and completion of work in the Project. It was also alleged that some of the allottees were adopting arm twisting tactics against Uppal for recovery of the amount already paid by them as they were not willing to take possession of their flats.

Observations of the NCLAT

The NCLAT observed that if allottees (financial creditors), financial institutions/banks (other financial creditors) or operational creditors of one project initiate CIRP against a real estate company (corporate debtor), it should be confined to only that particular project and should not affect any other project(s) of the same real estate company in other places having different land owners, allottees, financial institutions and operational creditors. Therefore, all the assets of the real estate company should not be maximized and CIRP should be on a project basis, as per the plan approved by the competent authority. Accordingly, allottees, financial institutions/banks or operational creditors of a real estate project cannot file a claim before the interim resolution professional of another project by the same real estate company and such claim should not be entertained.

The NCLAT further observed that secured creditors such as financial institutions/banks, cannot be provided with the asset (flat/apartment) in preference over the allottees (unsecured financial creditors) for whom the project has been approved. The claims of allottees would have to be satisfied by providing their flat/apartment. The NCLAT noted that normally, banks/financial institutions/NBFCs also would not like to take the flats/ apartments in lieu of the money disbursed by them. On the other hand, the unsecured creditors have a right over the assets of the corporate debtor.

The NCLAT also explored the issue of claim for refund by allottees and observed that such claims cannot be entertained in light of the judgement given by the Supreme Court in ***Pioneer Urban Land and Infrastructure Limited and Another v. Union of India and Others [2019 SCC online SC 1005]***, where it was held that, *"a defaulting allottee who has knocked the door of the court is a speculative investor and not a person who is genuinely interested in purchasing a flat/apartment and hence, when the real estate market is falling, the allottee does not want to go ahead with his obligation to take possession of the flat/apartment but wants to jump ship and get a*

refund of the monies paid by him by adopting coercive measures" (emphasis supplied). The NCLAT however, noted that after allotment is offered, it is open to an allottee to request the interim resolution professional/ promoter, whoever is in-charge, to find a third party to purchase the concerned flat/apartment and get her/his money back. It is also open to an allottee to reach an agreement with the promoter (not corporate debtor) for refund of her/his amount.

In view of the above observations, the NCLAT was of the opinion that where it is very difficult to follow the normal course of CIRP, a project specific CIRP process can be followed with respect to real estate infrastructure companies in the interest of allottees, survival of such companies, and towards ensuring completion of projects that provide employment to a large number of unorganized workmen.

Decision of the NCLAT

The NCLAT held that CIRP should be limited to a particular project by a real estate company as per the plan approved by the competent authority and not its other projects for which separate plans are approved. Accordingly, the CIRP in relation to the Project cannot not be clubbed with other projects of the Respondent and assets of such other projects cannot be realised. The appeal was disposed of with the aforesaid observations and directions.

VA View

In passing the Order, the NCLAT has outlined an important principle in CIRPs with far reaching consequences, one pursuant to which a CIRP against real estate companies would be confined to only those projects that have not been completed/ delivered and allottees of which are aggrieved (and bring action), and the same would not as a consequence affect other projects being developed by the same real estate company.

Further, towards dissuading homebuyers from misusing the insolvency forum, the NCLAT has under this Order also set out significant guidelines on the manner in which an allottee can claim refund in the event she/ he does not wish to take possession of a flat/ apartment in a Project undergoing CIRP.

Overall, the said Order encourages a more pragmatic and efficient approach to resolution of real estate companies under the IBC.

IV. NCLAT upholds JSW Steel's Resolution Plan for Bhushan Power, provides immunity from prosecution by ED

The National Company Law Appellate Tribunal (**"NCLAT"**) by its judgement dated February 17, 2020 in the case of ***JSW Steel Limited v. Mahender Kumar Khandelwal and Others*** *(Company Appeal (AT) (Insolvency) No. 957 of 2019)* allowed JSW Steel to acquire Bhushan Power and Steel Limited (**"BPSL"**) for INR 19,700 crores, while at the same time providing immunity from prosecution from the Enforcement Directorate under the Prevention of Money Laundering Act, 2002 (**"PMLA"**).

Facts

The Successful Resolution Applicant of the Corporate Insolvency Resolution Process (**"CIRP"**) of BPSL approached the NCLAT with a view to modify or set aside the conditions (e), (f), (g), (i), (j) and (k) of the impugned order dated September 05, 2019 passed by the National Company Law Tribunal, Delhi (**"NCLT"**). Another objection surrounding these conditions was the power of the Enforcement Directorate (**"ED"**) to attach the properties of BPSL after change of hands, parallelly addressing the larger issue of criminal liability post CIRP.

The relevant part of the condition imposed by the NCLT is:

"The criminal proceedings initiated against the erstwhile Members of the Board of Directors and others shall not affect the JSW-H1 Resolution Plan Applicant or the implementation of the resolution plan by the Monitoring Agency comprising of CoC and RP. We leave it open to the Members of the CoC to file appropriate applications if criminal proceedings result in recovery of money which has been siphoned of or on account of tainted transactions or fabrication as contemplated under the provisions of the Code or any other law. Those applications shall be considered in accordance with the prevalent law."

Thereafter it was informed to the NCLAT that a part of the assets of BPSL were attached via Deputy Director of ED's order dated October 10, 2019.

The Union of India was required to clarify its stand and accordingly it filed an affidavit in reply through the Ministry of Corporate Affairs in consultation with the Department of Financial Services and Banks stating:

(i) The provision of the Insolvency and Bankruptcy Code (Amendment) Act, 2019 by which Section 31(1) was amended, makes it amply clear that a resolution plan is binding on Central Government and all statutory authorities.

(ii) It is further submitted that the erstwhile management of a company would be held responsible for the crimes, if any, committed under their regime and the new management taking over the company after going through the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) process cannot be held responsible for the acts of omission and commission of the previous management. In other words, no criminal liability can be fixed on the successful resolution applicant or its officials.

(iii) In so far as the corporate debtor or its assets are concerned, after the completion of the CIRP, that is, a statutory process under the IBC, there cannot be an attachment or confiscation of the assets of the corporate debtor by any enforcement agencies after approval of the resolution plan.

(iv) The purpose and scheme of the CIRP is to hand over the company of the corporate debtor to a bona fide new resolution applicant. Any threat of attachment of the assets of the corporate debtor or subjecting the corporate debtor to proceedings by investigating agencies for wrong doing of the previous management will defeat the very purpose and scheme of CIRP which, *inter alia,* includes resolution of insolvency and revival of the company, and the efforts of the bank to realise dues from their Non-Performing Assets (NPAs) would get derailed.

(v) In light of the above, it is respectfully submitted that the ED while conducting investigation under PMLA is free to deal with or attach the personal assets of the erstwhile promoters and other accused persons, acquired through crime proceeds and not the assets of the corporate debtor which have been financed by creditors and acquired by a bona fide third party resolution applicant through the statutory process supervised and approved by the adjudicating authority under the IBC. Therefore, upon an acquisition under a CIRP by a resolution applicant, the corporate debtor and its assets are not derived or obtained through proceeds of crime under the PMLA and need not be subject to attachment by the ED after approval of resolution plan by the adjudicating authorities.

Considering the opposite stand taken by the ED, the orders of the NCLT and that of the Deputy Director of ED were stayed. Meanwhile, the newly inserted Section 32A of the IBC came into effect. The NCLAT asked the ED and the Ministry of Corporate Affairs to file an additional affidavit in reply in light of the same.

The Union of India through Regional Director, Ministry of Corporate Affairs, took a specific plea that JSW Steel (Resolution Applicant) does satisfy the conditions prescribed under Section 32A and cannot be held to be ineligible in terms of Section 32A(2)(i). JSW Steel was not held to be under investigation by the Central Bureau of Investigation (CBI), Serious Fraud Investigation Office, nor held to be a related party.

Issues

(i) Whether after approval of a 'Resolution Plan' under Section 31 of the IBC, is it open to the Directorate of Enforcement to attach the assets of the 'Corporate Debtor' on the alleged ground of money laundering by erstwhile promoters.

(ii) Whether JSW Steel (Resolution Applicant) is a related party to BPSL (Corporate Debtor).

Arguments

The ED took a plea that Section 32A introduced with effect from December 28, 2019 is prospective and would not apply to resolution plan which has already been approved under Section 31 of the IBC. It was submitted that the

resolution plan was approved on September 05, 2019 and Section 32A has come into force on December 28, 2019.

Another contention of the ED was that JSW Steel was a related party to BPSL and therefore, not an eligible party. It was stated that during the course of PMLA investigation, it has come to notice that BPSL and JSW Steel are associated as shareholders holding 24.09% and 49% equity respectively in a joint venture company namely 'M/s. Rohne Coal Company Private Limited'. As per the updated information filed with Ministry of Corporate Affairs in Annual Return 2018-19, the company was formed in 2008 and is still in operation.

Observations of the NCLAT

The NCLAT rejected the contention of ED regarding prospective effect of the amendment, and held that *"the preamble suggests that a need was felt to give the highest priority in repayment to last mile funding to corporate debtors to present insolvency in case the company goes into corporate insolvency resolution process or liquidation, to provide immunity against prosecution of the corporate debtor, to prevent action against the property of such corporate debtor and the successful resolution applicant subject to fulfilment of certain conditions and to fill the critical gaps in the corporate insolvency framework, it has become necessary to amend certain provisions of the Insolvency and Bankruptcy Code, 2016."*

The ordinance having been issued pursuant to direction of the NCLAT to the Central Government, applies squarely to JSW Steel.

With reference to the argument of a related party transaction, the NCLAT held that a person cannot be held to be ineligible till it is shown that it comes within any of the disqualifications under clauses (a) to (j) of Section 29A of the IBC. JSW Steel had clearly declared in their pleadings that the joint venture was entered into at the suggestion and behest of Government of India, through Ministry of Coal that had suggested the venture through their letter dated April 09, 2017 during the coking coal block allocation. Where a party for the purpose of its business, if mandated by the Central Government to join hands together and are forced to form a consortium or as joint associate, such person cannot be held ineligible in terms of Section 32A(1)(a) on the ground of 'related party'.

Thus, it was held that just by virtue of having investment in such downstream joint venture company, uniquely at the behest of the Central Government, does not make them a related party.

The NCLAT further held that in any event, by virtue of Section 238 of the IBC, the IBC has an overriding effect over anything inconsistent therewith in any other law. Accordingly, it is clear that subsequent promulgation of the ordinance is merely a clarification in this respect. Therefore, it is ex facie evident that the ordinance being clarificatory in nature, must be made applicable retrospectively.

Decision of the NCLAT

In view of the above, the NCLAT held that the attachment of assets of the 'Corporate Debtor', which is BPSL in the present case, by the Directorate of Enforcement pursuant to order dated October 10, 2019 is illegal and without jurisdiction.

VA View

This judgement of the NCLAT is based on sound reasoning and a logical application of the amendment that will declutter the numerous disputes pending at various levels.

A number of disputes surmount the Special Judge under the Maharashtra Protection of Interest of Depositors Act, that involves attachment of properties by the Competent Authority under the statute, thereby creating a conundrum involving arguments on applicability of the ordinance and matters of proof regarding 'proceeds of crime'. A similar situation prevails at the level of the ED, CBI, Serious Fraud Investigation Office and the Ministry of Corporate Affairs, allowing this judgement to demystify the dispute and maintain the purpose of the IBC.

The judgement also takes a strikingly liberal view of 'related party transactions', which in this case was a unique position for the companies, but nonetheless creates a precedent for such cases in the future.

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