

KNOWLEDGE SERIES 1 : NPAs, NCLT – Do's & Don't and Way Forward

NEW INSOLVENCY REGIME

- By notification dated November 15, 2019 the Central Government has from the 1st of December 2019 brought into effect Part III of the Insolvency and Bankruptcy Code, 2016 (“**Code**”).
- Consequently, Personal Guarantors have been brought within the purview of the Code from December 1, 2019.
- The Insolvency Process may be initiated by the Guarantor (i.e., the debtor) or by a creditor, either personally or collectively with other creditors or through a Resolution Professional.

IMPACT ON PERSONAL GUARANTORS

- Proceedings against the corporate debtor as well as personal guarantors may be initiated simultaneously.
- *Vice-versa*, Personal guarantors will themselves also be able to approach the Debt Recovery Tribunal or National Company Law Tribunal to claim their own insolvency.
- Easier and faster recourse for creditors against personal guarantor vis-à-vis the earlier regime wherein the creditors were to initiate recovery proceedings under the guarantee agreement and engage in prolonged litigation.
- Since the Code provides for a time bound process, the same will considerably reduce delays in recovery of dues of creditors from personal guarantors.

BRIEF PROCEDURE

- The newly notified regulations contained in Part – III of the Code, allows the Lender to approach Debt Recovery Tribunal(s) or National Company Law Tribunal(s) [In the event of pendency of a corporate insolvency resolution process or liquidation proceedings against a corporate debtor] (“**the Tribunal**”), as the case may be, for initiation of insolvency resolution process in respect of a debt which is owed by the Individual or Partnership Firm (“**the Debtors**”).
- An application made to the Tribunal has to be preceded by a Notice of Demand, which has to be responded by the Debtors within 14 days from the date of receipt of this Notice.
- Upon such application being made, a period of Interim Moratorium commences until acceptance of the application by the Tribunal.
- Within such period –
 - all debts cease to have effect,
 - legal proceedings get stayed, and
 - creditors are restrained from initiating any proceedings against the Debtors in respect of any debt.
- **RESOLUTION PROFESSIONAL:**
 - The Tribunal would thereafter appoint a Resolution Professional (“**RP**”) as may be recommended by the Insolvency and Bankruptcy Board of India, who is to
 - examine the application so filed by the creditor; and

- after examining its completeness thereof, including verifying repayment of debt if any by the Debtors, submit his report to the Tribunal recommending either acceptance or rejection of the application of the Creditor.
- **THE TRIBUNAL:**
 - Upon considering the RP's report:
 - may accept or reject the application of the Creditor.
 - Upon acceptance of the application:
 - a moratorium period of 180 days gets triggered.
 - The RP would thereafter ascertain all claims, form a Committee of Creditors ("CoC"), and decide their voting percentage.
- The Debtors in consultation with RP and CoC, are to prepare a repayment plan restructuring their debts, which if approved by $\frac{3}{4}$ th majority of the CoC (present in person or by proxy and voting); such plan along with the report of the RP is to be submitted to the Tribunal for approval.
 - Approval granted by the Tribunal is binding on all the creditors named in the repayment plan and debt so mentioned, and upon full implementation of such plan, the Tribunal may pass an order recording discharge of debt.

DEFENCES AVAILABLE UNDER THE CODE

- As per Section 8 of the IBC, proceedings may be resisted by either repaying the outstanding operational debt or *bringing into notice the existence of a dispute* in relation to such outstanding amount; 'existence' of such dispute referring to a suit or arbitration proceedings that must be pending *prior to service of demand notice*;
- In order to create a dispute, arbitration proceedings etc.; as per the relevant agreement are to be initiated, and the notice of such invocation of arbitration shall serve as evidence of 'existence' or a 'pre-existing' dispute, as was held by the NCLAT
- In case of financial debt, the test is whether the debt is "**due and payable**" coupled with a proof of the same as was held by NCLT, Delhi Bench

DOCUMENTS WHICH HAUNTS THE MOST IN COURTS

- ❖ **For an operational creditor**, an invoice raised by operational creditor after rendering service and time taken to dispute it becomes a determinative factor, which gives a first impression regarding the legitimacy of a transaction, coupled with the fact that no proceedings are initiated thereafter.
- ❖ **For a financial creditor**, admission of liability in balance sheets and negotiable instruments drawn in favor of lenders, are determinative documents which indicate that the debt is not only due but also payable; unless a subsequent agreement or arrangement entered with the Lenders is shown, indicating postponement of payment of the debt which had fallen due.

CRIMINAL PROCEEDINGS NOT COVERED UNDER MORATORIUM

- The NCLAT has answered the question of whether the order of moratorium will cover a criminal proceeding u/S. 138 of the NI Act, 1881 (“S. 138”) in the *negative*, and stated the following as its reasons for the same –
 - The Company cannot be imprisoned, therefore punishment u/S. 138 cannot be imposed against the Corporate Debtor. However, if found guilty, fine can be imposed by a court of competent jurisdiction on the Corporate Debtor.
 - S. 138 is a *penal provision*, which empowers the court of competent jurisdiction to pass order of imprisonment or fine, which cannot be held to be a proceeding or any judgment or decree of money claim.
 - Imposition of fine cannot held to be a money claim or recovery against the corporate debtor nor order of imprisonment, if passed by the court of competent jurisdiction on the directors, they cannot come within the purview of Section 14 of the IBC (“S. 14”).
 - No criminal proceeding is covered u/S. 14.
 - The court of competent jurisdiction may proceed with the proceeding u/S. 138, even during the period of moratorium.

IS RESTRUCTURING FORESEEABLE UNDER THE NEW RBI GUIDELINES?

- ❖ The Supreme Court in April 2019, quashed the much-debated Circular of the Reserve Bank of India (“**RBI**”) dated 12th February 2018 on “Resolution of Stressed Assets –Revised Framework” (“**the Circular**”) which instructed the lenders to initiate insolvency proceedings against defaulting companies. The Circular was struck down on the grounds of it being in contravention of Section 35AA of the Banking Regulation Act, 1949.
- ❖ However, the Circular is an indication of RBI’s mindset and intent to resolve restructuring issues only under the aegis of the Code.
- ❖ In fact RBI has issued a circular dated 12th February 2018 whereby it has laid emphasis of resolution of stressed assets though the provisions of the Code and have forthwith withdrawn all earlier framework such as such as Framework for Revitalising Distressed Assets, Corporate Debt Restructuring Scheme, Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring Scheme (SDR), Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets (S4A) and also the Joint Lenders’ Forum (JLF) as an institutional mechanism for resolution of stressed accounts also stood discontinued.
- ❖ All accounts, including such accounts where any of the schemes have been invoked but not yet implemented, were emphasized to be governed by the revised framework, which is the Code.
- ❖ So fate of all stressed assets will be determined under the provisions of the Code.

DO'S & DON'T FOR A DEVELOPER

1. Upon Application being filed but not admitted by NCLT :

- i. In case the application is filed by unsecured lenders and you can arrange funds to settle the amount at the value which is recorded in your books, then make the payment of that amount and inform the court that the balance amount is disputed.
- ii. If the value of the assets of the Company is much more than the liability, then it is advised to avoid any proceedings under NCLT and settle the matter before the application being admitted.
- iii. If the value of the assets of the Company is lower or equal than the liability but PG/CG is given then evaluate value proposition and accordingly opt or avoid any proceedings under NCLT and devise the strategy.
- iv. In case of Operational Creditors, always create records of non-performance as per the contract awarded.

2. Once application is admitted by NCLT under IBC:

Issues faced by the Company and its promoters

- i. IRP is appointed by the NCLT on the recommendation of the creditor who has filed the application. RP needs to be appointed by the COC once the COC is finalised by the IRP. COC has the power to appoint another person as RP or continue with the IRP as RP. It is very important that large COC members are convinced that RP appointed should not be only inclined towards following the instructions of the creditor who has filed the application. In case the IRP is appointed by the creditor who holds more than 35% of the COC voting rights, then this exercise cannot be performed. In any other case it is highly recommended that the RP should be the person not chosen by the creditor filing the application in NCLT.
- ii. Once the claims are received by IRP, when IRP asks for management confirmation, you should be actively involved as it helps in getting the necessary support at a later stage.
- iii. The records of other companies managed by the staff should be demarcated and kept separately.
- iv. Forensic auditor should be dealt with by the top management of the company so that information is passed on clearly and without any misunderstanding.
- v. RFRP that is the initial document for expression of interest prepared and sent by RP is very important as it determines the bidding criteria.
- vi. It is very important to make your views heard by the COC.

- vii. The appeal against the NCLT order in NCLAT should also be made and kept alive in order to have a backup for any adverse impact.
- viii. Another tool in the hands of Promoters is to keep the possibility of withdrawal of application under section 12(A).
- ix. Promoters who are not disqualified can also be one of the resolution applicants to submit the resolution proposal for the application filed under section 7, 9 or 10, if they qualify as per the criteria set out under RFRP.
- x. In case the process goes ahead through the resolution plan route, then distribution mechanism amongst the lenders is a major hurdle, for that atleast 66% voting should be secured.
- xi. The negotiation should be carried out with all the creditors who hold other securities, as it may create a problem later on.
- xii. Home buyers even though may represent lesser percentage in terms of voting rights, but should be dealt with properly to come to an amicable resolution, as they are larger in numbers and courts give them priority.

Admission under NCLT creates a pause kind of effect in the functioning of the Company, wherein the running numbers in each and every persons mind whether it is the lender or the borrower is crystallised. It provides a mechanism to stall the ongoing proceedings against the company/directors/promoters. But having said so, it is just a mechanism to stall, not to get rid of your debts and liabilities. All the stake holders still need to be settled whether amicably or by court order. It depends upon the complexity of the transaction and the value of the company whether to go in for the NCLT process or settle outside its purview. It all depends upon the negotiation power you have and what you may lose or ready to lose by choosing or not choosing the NCLT process.