VOLUME 4 ISSN 2456-9704

INSOLVENCY AND BANKRUPTCY CODE VIS A VIS NATURAL JUSTICE

By *Praveen P K*
From *School of Excellence in Law, Tamil Nadu Dr. Ambedkar Law University, Chennai*

1.0 INTRODUCTION:

Prior to 2016, Insolvency was a time consuming process in India making it appear at last on the list of countries with ease of doing business. There were thousands of pending cases for the recovery of money due to overlapping jurisdiction of various laws governing insolvency. At that scenario, it took almost 4 years to wind up a company in India. India was thus lacking institutional and legal machinery to deal with debt defaults as per global standards. The then existing Insolvency regime were either a century old or not effective enough to give the desired outcome of the recovery of outstanding debts. So the government under took a plan to replace the existing Insolvency laws with one consolidated and comprehensive law which will facilitate easy and time bound closure of business. So the Insolvency and Bankruptcy Code was passed by the Lok Sabha on 5th May, 2016 and then passed by the Rajya Sabha on 11th May, 2016. Finally it got the President's assent o 28th May 2016.

The Insolvency and Bankruptcy Code seeks to achieve a certainty in recovery and enforcement proceedings in debt recovery regime and to this extent it served as a useful tool for the creditors and investors. One of the important points is that, in contrast to the then existing Insolvency Regime, The Insolvency and Bankruptcy Code does not makes a distinction between the rights of domestic and international creditors or between the classes of financial institutions. Specific attention has to be drawn to the rights of unsecured and secured creditors in priority of their claims ensuring their level in the playing field for their access to an effective Insolvency Resolution. Moreover, the strict timelines for the IRP and Liquidation proceedings is a requisite impetus for the economic growth. Hence the Insolvency and Bankruptcy Code, in addition to improving the ease of doing business in India, also facilitated a better and faster debt recovery mechanism in the country. Though the Insolvency and Bankruptcy Code is one of the path breaking laws promulgated in the country, it should not do injustice to the Corporate Debtor in name of faster recovery of Debt. Section 7 of the Insolvency and Bankruptcy Code, under which the Financial Creditor can file an application for initiation of Insolvency Resolution Process before the Adjudicating Authority, doesn't mandate the Service of Notice to the Corporate Debtor. So, whether the non-obstante clause in the Insolvency and Bankruptcy Code has the power to override even the principles of Natural Justice (Opportunity of Being Heard) will be the main point of contention in this article.

2.0 AN OVERVIEW OF INSOLVENCY AND BANKRUPTCY CODE, 2016:

As stated by the preamble of the Insolvency and Bankruptcy Code (hereinafter referred to as The Code), its objective is to consolidate and amend all laws [1] related to insolvency and reorganization of corporate persons, Limited

Liability Partnership (LLP)[1], Partnership Firms and Individuals in a time bound manner with subsequently maximizing the asset value of the Corporate Debtor. Other incidental objectives include promotion of entrepreneurship, favoring the availability of credit balance, balancing the interest among all shareholders by altering the priority of dues etc.

The Code has 5 parts and 255 sections. But its general framework can be divided into three viz.

- Insolvency Resolution and Liquidation for Corporate persons and LLP (Part II of The Code)
- Insolvency Resolution and Bankruptcy for Partnerships and Individuals (Part III of The Code)
- Provisions regulating the Insolvency Professionals, agencies and Information Utilities (Part IV of The Code)

2.1 INSOLVENCY RESOLUTION PROCESS FOR CORPORATE PERSONS AND LLPs:

The Insolvency Resolution Process (IRP) can be initiated either by the financial creditor[1] or operational creditor[1] or by the corporate debtor[1] himself for a default of rupees one lakh or more by filing an application before the concerned Adjudicating Authority. Upon the acceptance of such application, a moratorium will be passed by virtue of which the creditors claim will be frozen for a maximum of 180 days. That is to say, no coercive proceedings can be initiated against the Corporate Debtor under any other forum or any other law[1]. The Adjudicating Authority may accept or reject the application based on the existence of default and if accepted, an Interim Resolution Professional will be appointed who shall manage the affairs of the Corporate Debtor. Further, the insolvency professional collect all details regarding the assets, finance and other operation of the Corporate Debtor and constitutes the committee of creditors. Then he has to manage the company as a going concern and has to protect and preserve the value of the assets of Corporate Debtor. The tenure of such Insolvency Professional shall not exceed 30 days. The committee of creditors constituted by the Insolvency Professional shall consist of all the financial creditors. (Operational Creditors can be a part of the committee without voting rights if their aggregate due is not less than 10% of total debt) excluding those related to Corporate Debtor (Section 5(24) of The Code). Resolution Professional shall be appointed with a vote of not less than 75% in the committee of creditors by the Adjudicating Authority. The Resolution Professional will conduct the Corporate Resolution Process & prepare the Resolution Plan. The Resolution Plan, which is laid before the committee of creditors, if accepted, can be used for restructuring process i.e. as a repayment plan for the company and if rejected, the debtor's assets will be liquidated to repay the debt.

By virtue of Section 12 of The Code, the Insolvency Resolution Process is supposed to be completed within 180 days from the date of admission of application. The IRP can be extended to a further period of 90 days if accepted by a majority vote of not less than 75% by the committee of creditors.

Apart from the failure of Resolution Plan, there are several other grounds under

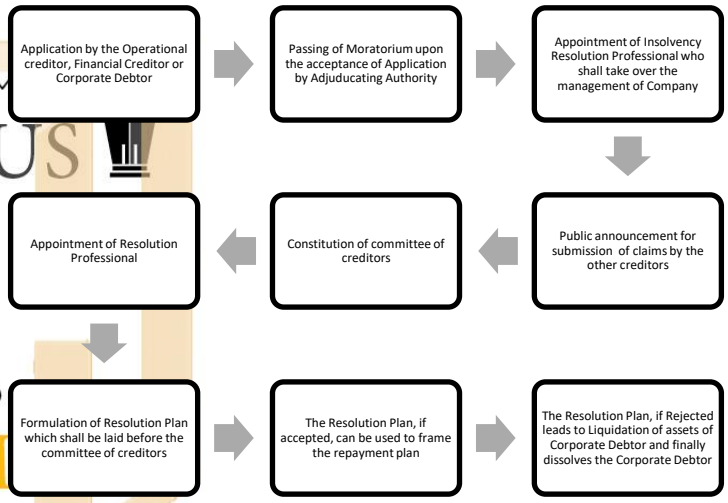
which a company can be liquidated which were enumerated in Section 33 of The Code.

- Rejection of Resolution Plan for non-compliance with the provisions of The Code
- Failure to submit the Resolution Plan within the prescribed time limit
- Contravention of Provisions of The Code by the Corporate Debtor

In Liquidation Process, the Resolution Professional can act as Liquidator unless replaced by the Adjudicating Authority or the committee of creditors. The liquidated asset shall be distributed in order of priority as laid down under section 53 of The Code[1].

- Insolvency Resolution cost and Liquidation cost
- Workmen's dues (for 24 months before the commencement of IRP) and the debts owed to secured creditors (who have relinquished their security interest in the manner provided U/S 52 of The Code)
- Wages and unpaid dues to employees (for 12 months before the commencement of IRP)
- Financial debts owed to unsecured creditors and workmen due for earlier period
- Crown debts (amount payable to the Central or State Government in two years preceding the commencement of Liquidation) & debts to secured creditors for any amount unpaid following the enforcement of security interest
- Remaining debts
- Preference Shareholders
- Equity Shareholders or partners
- Remaining surplus can be used to settle the interest accrued since the commencement of IRP

Upon the completion of Liquidation of assets, the Adjudicating Authority shall pass an order dissolving the Corporate Debtor. The whole process of IRP and Liquidation for corporate persons can be summed up into the following flowchart.



2.1.1 FAST TRACK RESOLUTION PROCESS:

Fast Track Resolution process is almost similar to the IRP with the only difference that it shall be completed within 90 days from the date of acceptance of application by the Adjudicating Authority. Extension can be given for the same for a further period of 45 days. This process can only be initiated by those qualified

Corporate Debtors as notified by the Central Government.

2.1.2 VOLUNTARY LIQUIDATION:

Generally, the IRP can be initiated only if there exists a default. But a Corporate Debtor, who has not committed any default, can himself enter into Liquidation which is famously styled as Voluntary Liquidation to pay off his debts from the proceeds of the same. The main condition precedent is that that there should be a declaration to that effect by the majority of Directors of the company or by the creditors representing 2/3rd of the company's debts, stating that the company is not being liquidated to defraud any person.

2.2 INSOLVENCY RESOLUTION AND BANKRUPTCY FOR PARTNERSHIPS FIRMS AND INDIVIDUALS:

Unlike the IRP of corporate persons and LLPs, the Insolvency Resolution and Bankruptcy in case of Partnerships and Individuals have no specified time limits. Because, Individual businesses are varied and vastly different with no standardized information about their activities are available so as to frame a generalized time period for the completion of IRP. A default of 1000 rupees or more will trigger the IRP for Partnership and Individuals. The procedure is almost similar to the IRP and Liquidation (Bankruptcy in case of Partnership and Individuals) for corporate persons and LLPs with some minor differences with respect to the Adjudicating Authority and persons eligible for invoking Insolvency proceedings.

2.2.1 FRESH START PROCESS:

Those debtors who are qualified under section 80[1] of The Code can apply for the Fresh Start Process to the concerned Adjudicating Authority for discharging the debts up to a certain threshold (not exceeding rupees 35,000). This method is exclusively available only for the Individuals and Partnership firms. Upon the acceptance of the application filed by the Individual Debtor, interim moratorium (Sections 80 (1)-(2) & 85 of The Code) will be passed after which the Resolution professional shall be appointed. He shall formulate the Resolution Plan, which if accepted by the Adjudicating Authority, shall be executed.

2.3 ADJUDICATING AUTHORITY:

The Adjudicating Authority for the Insolvency Resolution and Liquidation of the Corporate Persons and LLPs (Including the Bankruptcy of the personal guarantor of Corporate Persons) is the National Company Law Tribunal (NCLT) as constituted by the Section 408 of the Companies Act of 2013. The jurisdiction is based on the location of the registered office of the Corporate Debtor. It has to power to entertain an application made by or against a Corporate Debtor (Including his Subsidiaries), to deal cases involving question of priority, question of Law, question of fact in relation to the Insolvency Resolution and Liquidation of Corporate Persons. Appeals from the orders of NCLT can be made to the National Company Law Appellate Tribunal (NCLAT) as constituted by Section 410 of the Companies act, 2013 within 30 days from the date of order[1]. NCLAT orders can further be appealed to the Supreme Court of India only on question of Law arising out of that order within 45 days from the date of

receipt of such order. (Can be extended to 60 days on sufficient cause).

In case of Partnerships and Individuals, The Debt Recovery Tribunal (DRT) as constituted under Section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 shall be the Adjudicating Authority. Orders of DRT can be appealed to The Debt Recovery Appellate Tribunal (As constituted U/S 8 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993) within 30 days of the said order. It can further be appealed to The Supreme Court within 45 days (can be extended to 60 days) on the ground of question of Law arising out of such order.

2.4 OFFENCES AND PENALTIES:

The Code provides for punishments for various wrongdoings with a view to ensure serious and meaningful Insolvency process. Some of the common Insolvency offences include concealment of property by the debtor, entering into a transaction with intent to defraud creditors, misconduct in course of IRP, falsification of book of accounts, willful and material omission of statements relating to the affairs of the Corporate Debtor, false representation to creditors, contravention of resolution plan or moratorium etc. The maximum punishment given to Corporate persons is imprisonment up to 5 years or fine up to one crore rupees[1].

2.5 SALIENT FEATURES OF THE CODE:

- It separated the commercial aspect of the Insolvency proceedings from the judicial aspects. That is to say, while the Insolvency Professionals deal with the management of the affairs of the Corporate Debtor (formation of creditors committee, resolution plan etc.), the adjudication will be dealt by the NCLT and DRT respectively.
- The Code facilitates the transfer of the control over the affairs of the company to the committee of the creditors upon the default of Corporate Debtor for 180 days during which the repayment plan shall be formulated. It helps in maintaining the company as a going concern through Resolution Professional thereby facilitating the maximum use of productive resources of the economy (Labour & Capital).
- Cross border Insolvency introduced by The Code provides that the Central Government can enter into agreements with foreign nations for enforcing the provisions of the code (Section 234 of The Code). Further, the assets of the Debtor located outside India can also be included for the purpose of Insolvency/Liquidation process[1]. So The Code aims at bringing all the creditors (whether local or foreign) on same footing.
- The Code provides for an Institutional Infrastructure in the Insolvency regime. It established the Insolvency and Bankruptcy Board of India to oversee the functions of the Insolvency intermediaries like Insolvency Professionals, Insolvency Professional Agencies and

Information Utilities[1] and to regulate the Insolvency process.

3.0 APPLICATION UNDER SECTION 7 OF THE CODE:

Section 7 gives power to the financial creditor to file an application before the NCLT for the initiation of IRP against the Corporate Debtor provided that the amount of default is not less than one lakh rupees. The condition precedent for invoking IRP is the existence of default. According to Section 3(12) of The Code, default means the nonpayment of debt when whole or any part or installment of the amount of the debt has become due and payable, but has not been paid by the Corporate Debtor. The basic essence is that when a financial creditor files an application before NCLT, it has to be construed as being filed jointly by all other financial creditors. So it is not necessary that the default must be related only to the financial debt owed by the Corporate Debtor to the applicant. Along with the application, the financial creditor is supposed to furnish such documents as evidence to the default, the name of the Resolution Professional who is proposed to act as an Interim Resolution Professional and any other documents as may be specified by the board.

Then the NCLT has to ascertain the existence of default from the records on Information Utility and the documents submitted by the financial creditors within 14 days from the receipt of application. If the NCLT is satisfied with the existence of default and there is no disciplinary proceeding pending against the proposed Resolution Professional, it may accept the same. In case of incomplete application, the NCLT may reject the application by giving seven days time to the applicant to rectify the application. The Corporate Insolvency Resolution Process starts upon the acceptance of the application and the same shall be communicated to the financial creditor and the Corporate Debtor.

Thus the plain reading of Section 7 of The Code provides that the financial creditor can directly file an application before the NCLT without even providing a demand notice to the Corporate Debtor. He is being notified only after the acceptance of the application by NCLT which serves no purpose. Because, after the acceptance of the application by NCLT, moratorium will be passed by virtue of which the management of the affairs of the Corporate Debtor will be divested to the interim Resolution Professional. So the Corporate Debtor was not given an opportunity to defend himself.

4.0 PRESUMPTION IN FAVOUR OF NATURAL JUSTICE:

Natural Justice is synonymous with jus naturale (Natural Law) which means that some rules need to be so just that they are binding on the entire mankind[1]. What it requires is fairness by the concerned authority and what is fair depends on the situation and context. It acts as a procedural safeguard against abusive, wrong or undue use of power conferred particularly when such power is prejudicial to particular person(s). Bhagwati J has characterized natural justice as a humanizing principle, infusing law with fairness to secure justice[1]. But this is not a normal norm of administrative procedure. Whether or not a particular administrative action is subject to fair hearing depends on the context of each case. Nevertheless, unless a statute either

specifically or by necessary implications excludes the operation of the Principles of Natural Justice, the requirement of giving reasonable opportunity of being heard before a Quasi Judicial order is passed is generally read into the provisions of the statute.

To put it in other words, a Quasi Judicial Body [1], while acting under the provisions of the act must follow the Principles of Natural Justice. So Right of Hearing can be invoked when there is a lis (contest) between two contending parties and there is an Adjudicating Authority deciding the dispute. For instance, the Central Government, which is deciding a dispute between the Director of a company who has discretionary power of refusing to register a transfer of share and the aggrieved party, is supposed to give reasonable opportunity of being heard to both the parties as its order is of Quasi Judicial nature.

The Insolvency and Bankruptcy Code, by virtue of Section 60 has empowered the NCLT to be Adjudicating Authority in relation to IRP and Liquidation of Corporate Persons and LLPs. The NCLT is deciding a dispute between the Corporate Debtor and Financial Creditor and the order will be prejudicial to either one of them. So, the NCLT is indeed a Quasi Judicial Body and hence it is bound by the Principles of Natural Justice. This has been affirmatively laid down in the landmark case of "Innoventive Industries Ltd. v. ICICI Bank & Anr".

4.1 ANALYSIS OF INNOVENTIVE INDUSTRIES LTD. V. ICICI BANK CASE[1]:

The main contention in this case was that the impugned order was passed by the NCLT without issuing notice to this Corporate Debtor (Innoventive Industries) which is against the Principles of Natural Justice as stipulated by Section 424 of the Companies Act, 2013. Another corollary question which comes along with the contention is that How far the Principles of Natural Justice are essential so as to read into the lines of statute?

4.1.1 WHEN NATURAL JUSTICE CAN BE EXCLUDED?

Basically, Rules of Natural Justice are essential elements of the procedure established by Law. It can be exclude only on some exceptional circumstances [1]. The word exception here is a misnomer because in these exceptional circumstances, the Principles of Natural Justice (Audi Alteram Parteram in this case) are held inapplicable not by way of an exception to the fair play in action but because nothing unfair can be done by not affording an opportunity to present a case[1]. The object of Audi Alteram Parteram is to inject justice into the law and so the same cannot be applied to defeat the ends of justice. Only if the importing of Audi Alteram Parteram has the effect of paralyzing administrative process or there is a need for prompt action or the urgency of situation so demands, the Audi Alteram Parteram can be wholly excluded. Thus Natural Justice is a flexible rule and is amenable to capsulation under compulsive pressure of circumstances[1].

Moreover, the rules of Natural Justice cannot be elevated to the status of Fundamental Right. Only if the statutory provisions can be read consistently with the

Principles of Natural Justice, the court can apply the same[1]. And if the statute excludes it by necessary implications, the court cannot ignore the statutory mandate. So the Right to be heard cannot be presumed where the delay in action would defeat the very purpose of the act[1].

The Principles of Natural Justice operates only in areas not covered by law. That is to say, it can only supplement law and not supplant it[1]. Whether or not, the application of Principles of Natural Justice has been excluded, wholly or in part, in the exercise of statutory power, depends on the language of the statute, basic scheme of the provisions conferring such power, the nature and purpose for which the power is conferred and the effect of exercise of such power[1].

Now, it's clear that the Principles of Natural Justice can be excluded by the express language of the statute. But what if the statute conferring power does not expressly exclude the rule but the same is sought by the necessary implications? General rule is that it is not permissible to interpret a statute so as to exclude the Principles of Natural Justice[1].

Because, the Principles of Natural Justice is fundamental in the concept of ordered liberty and therefore, implicit in every decision making function, call it judicial or Quasi Judicial or administrative. Statutory silence with respect to the applicability of the Principles of Natural Justice implies the compliance with the same. Such presumption can be removed only if there is a conflict with public or private interest. Hence, unless the law expressly or by necessary implications excludes the application of Principles of Natural Justice, the courts will read the said requirement in those enactments which are silent and insists its application even in case of administrative action having civil consequence[1].

From the above findings, the grounds on which the Principle of Natural Justice can be excluded are summed up as,

- In case of Emergency
- Express statutory exclusion
- Prejudicial to public interest
- Prompt action
- Impractical to hold hearing
- No persons' rights have been infringed
- Procedural defect has made no difference to the outcome.

4.1.2 INSOLVENCY AND BANKRUPTCY CODE IN RELATION TO NATURAL JUSTICE:

As stated earlier, the main issue addressed in this article is that whether The Code can claim any of the above mentioned grounds so as to exclude the Principles of Natural Justice under Section 7?

On paper, there is no express provision in The Code which mandates the Service of Notice to the Corporate Debtor at the stage of filing of application by the financial creditor. But, as per the provisions of The Code, the Adjudicating Authority for the IRP and Liquidation of Corporate Persons is the NCLT [1] as constituted by Section 408 of the Companies Act, 2013. Being a creature of the Companies Act, NCLT is bound by the Section 420 which says that the Tribunal should provide a

reasonable opportunity of being heard to the parties concerned and Section 424 which says that the Tribunal is not bound by the Code of Civil Procedure and so, to regulate its own procedure, it should follow the Principles of Natural Justice.

So, NCLT has to apply the Principles of Natural Justice as a part of the procedure while hearing an application under Section 7 of The Code. Moreover, a proceeding for declaration of Insolvency of a company has drastic consequences. It may even end up in Liquidation of the company. So the concerned person cannot be condemned unheard. When the statute is silent on Right of Hearing and it does not, in express terms, oust the principles of Natural Justice, the same can and should be read into the statute. Hence the NCLT is obliged to afford a reasonable opportunity to the Corporate Debtor to present his case before admitting an application filed by the financial creditor[1].

This view is further substantiated by the Section 7(4) of The Code read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (I&B (AAA), Rules). Section 7(4) of The Code requires that the Adjudicating Authority to ascertain the existence of default by considering the documentary claims of the financial creditor. This mandates the extension of Right of Hearing to the Corporate Debtor so as to negotiate the same. Further Rule 4(3) of the I&B (AAA) Rules, 2016 requires the financial creditor to dispatch a copy of application filed by him before the Adjudicating Authority to the Corporate Debtor at the stage of filing of application.

5.0 CONCLUSION:

As the application U/S 7 of The Code has serious civil consequences, not only to Corporate Debtor but also to the Directors and Shareholders, i.e. following the application, Insolvency Resolution Professional will be appointed to manage the affairs of company with instant removal of the Board of Directors, the Adjudicating Authority is bound to issue notice to the Corporate Debtor. It is evident from the perusal reading of the Code that it is definitely an effective move towards establishing a strong regulatory framework to deal with insolvency and liquidation problems. However, the Code is at its nascent stage, it will take time to cross various practical and logistical hurdles before becoming fully comprehensive and consistent. At present, the Code illustrates a picture detrimental to the interest of debtor companies instead of a balance of interest between corporate debtors and their creditors. However, it can be hoped that such interest will be protected in future.

REFERENCES:

3) Statutory Material:

Insolvency and Bankruptcy Code, 2016

2) Secondary Sources (Books):

M P Jain & S N Jain, Principles of Administrative Law, pp 232-311, (6th ED. Lexis Nexis, 2010)

A B Kafaltiya, Textbook on Interpretation of statutes, pp 213-214, (2nd ED. Universal Law Publishing, 2017)

3) Online Articles:

Anubav Pandey, Insolvency & Bankruptcy Code, 2016 – Key Highlights, iPleaders, (Nov 1, 2017), http://blog.ipleaders.in/insolvency-and-bankrupycy-2/

Anil Kumar Popli, Key Features of Insolvency & Bankruptcy Code, 2016, Tax Guru, (May 17, 2016), www.taxguru.in/corporate -law/key-features-insolvency-bankruptcy-code-2016/

Divesh Goyal, Over Riding Effect of Insolvency and Bankruptcy Code on other acts, Tax Guru, (June 26, 2017), http://taxguru.in/corporate-law/

Govindarajan M, Validity of Section 7 of Insolvency and Bankruptcy Code, 2016, Tax Management India, (Oct 25, 2017), www.taxmanagementindia.com/visitor/

Himanchu Chaula, India: Insolvency Code- Has Corporate Debtor Have No Say? Mondaq, (Aug 23, 2017), www.mondaq.com/

Lalith Ajmani, India: Application under Section 7- A Brief Analysis, Mondaq, (Aug 24, 2017), www.mondaq.com/

Neha Somani & Utsav Lohia, Natural Justice Vis a Vis Insolvency and Bankruptcy Code- Audi Alteram Parteram: An Unraveled Mystery, Live Law.in, (July 2, 2017), www.livelaw.in/

Pooja S Mahajan, India: NCLAT Observations on the Insolvency and Bankruptcy Code 2016 – The Innoventive Industries Ltd v. ICICI Bank, Mondaq, (Sept 5, 2017), www.mondaq.com/

Sabooankur, Procedure in case of Corporate Debtor under the Insolvency and Bankruptcy Code, 2016, iPleaders, (Sept 1, 2017), http://blog.ipleaders.in/corporate-debtor-ib-code-2016/

The Insolvency and Bankruptcy Code, 2016 – Key Highlights, TRILEGAL, (May 16, 2016), www.trilegal.com/

Umakanth Varottil, NCLAT: Order U/S 7 of The Insolvency and Bankruptcy Code, 2016, India Corp Law, (May 23, 2017), http://indiacorplaw.in/2017/05/

Upasana Gupta, The Insolvency and Bankruptcy Code, 2016 – Key Highlights, CAClub India, (July 14, 2017), www.caclubindia.com/

Visvanathan L & Indrani Deshmukh, NCLAT defines the scope and extent of the Corporate Debtors Rights in context of admission of Insolvency application file by Financial Creditor, India Corporate Law, (May 27, 2017), http://corporate.cyrilamarchandlogs.com/

Vijay K Sondhi, The Curious Case of Insolvency and Bankruptcy Code, 2016, Industrial Articles, (Aug 1, 2017), www.oakbridge.in/

What does the Insolvency and Bankruptcy Code 2016 do? Legally India, (May 12, 2017), www.legallyindia.com/

*****