

## **STRIKING A BALANCE BETWEEN CORPORATE DEBTORS AND CREDITORS: AN ANALYSIS OF THE INSOLVENCY AND BANKRUPTCY CODE**

Written by *Atreya Mathur\**

\* 3rd Year BBA LLB Student, Christ University, Bangalore

---

### **ABSTRACT**

*One of the most contemporary issues in the field of law is that of the process of insolvency and liquidation especially with regard to the Insolvency and Bankruptcy code recently introduced in India to establish an effective regulatory framework for liquidation and insolvency related matters.*

*While the Insolvency and Bankruptcy Code provides for insolvency resolution in a timely manner and establishment of an expedient process to decide the application and to opt for the process of liquidation if the plan is rejected, it doesn't seem to provide for any involvement of the corporate debtor which could lead to a negative impact on the company.*

*On an analysis of relevant provisions of the Code from the perspective of a corporate debtor, it can be seen that the Code gives great powers as well as rights to the financial creditor to get back their loans but no recourse is given to the corporate debtors to address their grievances. An imbalance is created favouring the creditors against the corporate debtors.*

*While the object of the Code is to give priority to the creditors, through various case laws it can be seen that the corporate debtor was genuinely concerned and interested in revival and paying back loans but the creditor's power prevailed and the company was taken into liquidation. The issue that arises is whether the debtor should be taken into consideration during this process.*

*The financial creditor can file an application for the initiation of Corporate Insolvency Resolution Process to the Adjudicatory Authority in the case of commission of default and it is*

mandated the applicants submit a copy of the application filed with the Adjudicatory Authority. The main purpose is to give the corporate debtor adequate notice that such an application has been filed against him.

However, another issue that can be seen is that the Code does not provide any provision for corporate debtor to make a representation in furtherance of such notice. The Code doesn't take into account the circumstance under which the financial creditor might have hidden relevant documents which could reject the application.

In the judgment of **Sree Metaliks Limited v. Union of India**<sup>1</sup>, it was stated that a reasonable opportunity of hearing to the corporate debtor must be afforded despite the High Court of Calcutta stating that the Adjudicating Authority is to adhere to Natural Justice Principle when deciding on an application under Section 7 of the Code.

The same rationale was also followed in the case of **ICICI Bank v. Innoventive Industries Ltd**<sup>2</sup>, where it was stated that the Insolvency Resolution Process under Section 7 of the Code would have serious consequences on the corporate debtors as well as on the directors and shareholders as after the application is filed, an interim resolution professional is appointment to manage affairs of the corporate debtor and there is instant removal of the Board of Directors.

While in these cases, through the judgments it can be seen that the Courts recognize the importance and need of recourse for the debtor, the Code by itself does not provide any recourse for the corporate debtor to raise the grievance. There is no written procedure laid down for the hearing given to the corporate debtor.

At present, the Code illustrates a picture that seems to be in favour of the creditor resulting in an imbalance between the corporate debtors and creditors. Through this paper, after an analysis of case laws and relevant sections of the IBC, the need to strike a balance between the corporate debtors and the creditors is considered to ensure that the objects of the Code are

---

<sup>1</sup> WP 7144(W) of 2017, Calcutta High Court

<sup>2</sup> Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017

*achieved as well as various suggestions as to how the corporate debtors needs can be incorporated into the Code.*

## **INTRODUCTION**

The Insolvency and Bankruptcy Code, 2016 as defined by the act is an “Act to consolidate and amend the laws relating to reorganisation and Insolvency Resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.”<sup>3</sup>

With reference to the Eradi and Vishwanathan Committee Reports, the main objectives of the act are as follows:

- To establish a regime for early detection of inefficiencies and the systematic abuse of corporate insolvency.
- To have a safeguard from the distressed state of credit markets in India.

The financial sector reforms resulted in transformation of the equity, currency and commodity markets. Despite considerable policy efforts, the credit markets continued to malfunction, one of the most significant factors being that the mechanism for resolving insolvency was holding back the markets. Debtors were also unable to repay large amounts that were borrowed from creditors. The laws existing at the time seemed inefficient and were enforced rather poorly. The Insolvency and Bankruptcy Code was enacted increase the efficiency of the entire process including codifying and amending the laws across various legislations.

The Code aims to protect the creditors so as to ensure that they are repaid the money due to them.

## **ISSUES**

---

<sup>3</sup> Insolvency and Bankruptcy Code, 2016

The main issues that can be identified is that from the perspective of a Corporate Debtor there is inadequate protection that is provided for by the code. The Code confers great power to the financial creditor and grants several rights so that the creditors are able to retrieve their amount given as loan. But the debtor does not have any recourse to address the grievances faced in the repayment. There are several instances in which the debtors were interested in paying back the full amount of the loans and were in favour of corporate revival but were unable to due to the power of the creditor to take the company into liquidation.

### THE CONCEPT OF PUBLIC HEARING



Figure 1: Corporate Insolvency Resolution, The Process

Source:

MyLaw

***An Analysis of Section 7 of the Code:***

Section 7 of the Code states that the financial creditor can file an application in order to initiate the Corporate Insolvency Resolution Process to the Adjudicating Authority in the case that there has been a default that has been committed.<sup>4</sup> The process for Corporate Insolvency Resolution can be seen in Figure 1 above.

In relation to Rule 4(4) of the Adjudicating Authority Rules<sup>5</sup>, it is mandated that the applicants are to dispatch a copy of the application that had been filed with the Adjudicating Authority. This would give the corporate debtor notice which is adequate in nature that there has been application filed against him for the initiation of the Corporate Insolvency Resolution Process. However, the corporate debtor by provisions of the code does not have a right to make any representation in pursuance of the notice so filed. There is no account that has been taken by the Code for situations in which there was concealment of important and relevant documents of the financial creditor that could have led to the rejection of the application altogether.

***Sree Metaliks Limited v. Union of India***<sup>6</sup>:

In this case an application under section 7 of the Code was looked into. The financial creditor was the applicant while the corporate debtor was the respondent. The court stated that a proceeding that is initiated for the purpose of declaration of insolvency has “drastic consequences” for the company. A proceeding such as this could lead to the liquidation of the company. A person can therefore not be condemned when unheard. Where this is case for which he statute is silent on the right of hearing and the principles of natural justice are not followed, it is imperative that it is read into. When an application is received by the under Section 7 of the Code, it must therefore afford a reasonable opportunity to the corporate debtor

---

<sup>4</sup> Section 7, Insolvency and Bankruptcy Code, 2016

<sup>5</sup> Rule 4(4), Adjudicating Authority Rules

<sup>6</sup> WP 7144(W) of 2017, Calcutta High Court

to be heard as the provisions of the Companies Act, 2013<sup>7</sup> mandates it to ascertain that there is the existence of default as was claimed in the application by the financial creditor.<sup>8</sup>

***Analysis of the Judgment:***

In this case it can be seen that the Calcutta High Court stated that the Adjudicating Authority must follow the principle of natural justice when any application is being decided under Section 7 of the Code. There must be a reasonable opportunity that is given to the debtor to be heard so as to ensure that the principle may be adhered to. The rationale of this judgment clearly states that the objective of the court was to ensure that there is equity in such cases and a balance may be sought between the financial creditor and the corporate debtor.

***ICICI Bank v. Innoventive Industries Ltd***<sup>9</sup>:

Section 7 and 9 of the Code was taken into consideration in this case. It was held that the Insolvency resolution Process has “serious civil consequences” both on the company as well as the corporate debtor as when the application under Section 7 and 9 of the Code has been admitted, there is an interim resolution professional who is appointed to manage affairs of the corporate debtor.

***Analysis of Judgment:***

In this case it can be seen that the court stated that there are civil consequences faced not only by the directors as well as the shareholders of the company but also the corporate debtors as they no longer manage the affairs of the company. The rationale followed in **Sree Metaliks Limited v. Union of India** has been applied here, however, while these cases take into consideration the impact and consequences in relation to the corporate debtor, the code in itself does not allow for grievance to be raised by the debtor. The Adjudicatory Authority is responsible to make way for the debtor in order for the debtor to represent himself. This implies that there is no procedure that is either formal or in a written format that allows the debtor to be given any hearing.

---

<sup>7</sup> Section 424 of the Companies Act, 2013

<sup>8</sup> WP 7144(W) of 2017, Calcutta High Court

<sup>9</sup> Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017

## **ASCERTAINING THE DEFAULT**

### *Analysis of Section 7 of the Code:*

In accordance with Section 7(4) of the Code, it is the duty of the Adjudicatory Authority to ascertain the existence of default so that the application could either be accepted or rejected. This would allow for the default to be ascertained.

The essence of the section being that the authority would only look into the application to determine whether there has been a default when a creditor has filed such application when a company failed to pay an amount after which the authority would admit the application and an interim resolution professional would be appointed to take over the management of the company.

In the Case of Essar Steels where the company was directed by the Reserve Bank of India to be sent to the National Company Law Tribunal<sup>10</sup>, the revival plan was approved by the creditor. In this case it can be seen that there was cooperation and an amicable agreement that was reached upon.

If the creditor decides to file an application for the initiation of the Resolution Process, the interim professional would have management over the company and it would be difficult to revive the company once it is sent for liquidation.

## **COMMITTEE OF CREDITORS AND THE RESOLUTION PROFESSIONAL**

---

<sup>10</sup> Reserve Bank of India, Master Circular of 20153

An Interim Resolution Professional is to be nominated but the creditors when an application for initiation of the process is filed. A Committee of Creditors is then formed by the professional. A new Resolution Professional is then appointed by the committee to take over the interim professional duty, The new professional, as per the provisions of the code, work in favour of the creditor only. The revival plan so presented focuses on the demands of the creditors disregarding the debtor altogether. Creditors in such a case can take advantage of the situation and make expeditious demands. In cases where there could have been revival of the company, and if the committee of creditors rejects such a plan, it can be taken into liquidation.

The Code does provide for the filing of a complaint against the professional by any person in front of the Board after which there would be an investigation and report to be presented in front of the Boar. A disciplinary committee would be responsible for the examination of such a report and penalty would be imposed if there is cause; sufficient in nature which exists.

This process is extremely lacklustre and lengthy in nature. While this is provided for in the Code, it seems more of a futile gesture that would really lead to no concrete or substantial result.

## **RECOMMENDATION FOR ACTION**

There should be steps taken to ensure that the process as mentioned in the Insolvency and Bankruptcy Code takes into the account the needs of corporate debtors and financial creditors. There should be balance between the two that is sought.

- The procedure for filing an application to complaint against Insolvency Professional or Insolvency Professional Agency or Information Utility by any person in front of the Board should be revised. As of now it is tedious and would be of no use. A simpler process with the condition of relevant documents and evidence should be taken into consideration.
- There should be the inclusion of a provision which lays down that for cases where there is genuine concern for revival by debtors, protection should be given besides a fair chance of hearing.



- The objectives of the act should include balancing of interests between parties involved to reach the most effective solution.
- There should be continued discretion of courts as mentioned in the cases discussed to ensure that consideration is given to the debtors.

## **CONCLUSION**

The Insolvency and Bankruptcy Code is still in its early stages and is a relatively new concept. While the Act has been successful in achieving the purpose of amending and codifying the laws in relation to corporate insolvency, as well as for establishing a regulatory framework that effectively deals with the problems of insolvency and liquidation, there is scope for its improvement.

In the present case, the code seems to be more in favour of the creditors disregarding the debtors who are genuinely interested to payback the debts and revive the company. There is an imbalance that is created detrimental the needs and interests of the debtors. There should be a balance that is sought in terms of the interest between the corporate debtors and financial creditors. The Code is still in its early stage so there is possibility for this to be achieved. With the help of decided cases and interpretations of judges showing the interest of the debtors, there is hope that such interest of the debtors will be protected in the near future.

