

NCLT Takes A Detour From IBC For A ‘Workable Solution’ In SBM Paper Mills Case

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In this insolvency fairytale, a charming princess (resolution applicant) tries to save the distressed prince (insolvent company) from the clutches of financial misery. And the stepfather (promoter barred by law from participating in the insolvency) represents the spoke in the wheel attempting to hinder their happy ending.

The story is about the insolvency proceedings of SBM Paper Mills Pvt. Ltd. - in which the Mumbai National Company Law Tribunal was asked for three very contradictory rulings:

- The resolution professional sought approval of the resolution plan submitted by Maharashtra-based flour mill Khandesh Roller Flour Pvt. Ltd. (the resolution applicant). This plan had already been approved by the committee of creditors.
- The promoter/erstwhile promoter, Satyanarayan Malu, sought withdrawal of the insolvency he himself had initiated on behalf of the company.
- The resolution applicant sought withdrawal its resolution plan, after the plan had been negotiated, re-negotiated and accepted by the committee of creditors.

So, who got their happy ending?

The short answer is — all of them.

The single-judge bench ruled in favour of the promoter and allowed for the withdrawal of the insolvency application, 430 days after it had been admitted.

The promoter offered a value nearly 30 percent more than that offered by the resolution applicant. That served the purpose of the sole creditor — Allahabad

Bank. And the resolution applicant decided it didn't want the distressed asset after all.

The outcome must have pleased all three parties. The framers of Insolvency and Bankruptcy Code, not so much.

Canny Lender, Creative NCLT

Allahabad Bank, the sole creditor in this case, negotiated with both the resolution applicant and the promoter, parallelly.

As the CoC, it first accepted Khandesh Roller Flour's resolution plan prompting the resolution professional to seek NCLT approval for the plan.

Around the same time, the promoter offered the bank Rs 18 crore in a 'one-time settlement', nearly 40 percent more than Rs 12.5 crore offered by the resolution applicant.

The bank accepted, possibly prompting the resolution applicant to withdraw its plan.

Then, the promoter, acting in capacity as director of the corporate debtor, sought to withdraw the insolvency plaint.

The fact that the resolution applicant wanted to withdraw its plan would have meant liquidation for SBM Paper Mills. But this situation was narrowly avoided since the NCLT allowed withdrawal of the insolvency application itself.

Stating that the IBC must subscribe to a 'creative interpretation' but 'laxman rekha' (line of control) must be drawn to ensure that the main legislative intent is not disturbed, the NCLT noted that the one-time settlement is a commercially viable proposition for maximisation of value of assets, the primary intent of IBC. The alternative—liquidation, which would have been the only option if the resolution applicant withdrew its plan and the insolvency application was not permitted to be withdrawn. This would not be in the interest of the distressed company and the various stakeholders, said the tribunal.

Withdrawing the insolvency proceedings at the closing stages of the process, when the only step left is for the NCLT to approve the selected resolution plan, is not only a waste of time and effort but also unfair to other participants and applicants and is certainly not a good practice to propagate under the IBC,

Vyapak Desai, head of the litigation and dispute resolution practice at law firm Nishith Desai Associates, told BloombergQuint.

But at the same time, in light of the recent Supreme Court ruling in Brilliant Alloys' case, insolvency application may now be withdrawn at any time if the procedural requirements are complied with. This has given parties leeway. Vyapak Desai, Head of Litigation and Dispute Resolution Practice, Nishith Desai Associates

There is a need to enforce a holistic and pragmatic approach to ensure that one does not intentionally and unnecessarily misuse the code to frustrate the resolution proceedings, which will be against the spirit of the code, Desai added.

Happy Ending But...

And though each got the end they wanted, they also paid a price for it. At least two did.

The NCLT strongly reprimanded the promoter for withdrawing the application (on behalf of the company) at such a late stage. It noted that the code should not be made a tool for deferment of payment of liabilities and imposed a penalty of Rs 5 lakh on the distressed company.

"I am not sure if the tribunal, being an adjudicating authority, has the jurisdiction to impose penalty in the manner in which it has done in this case. Also it is curious that the tribunal concluded that the petition can rightly be withdrawn but still proceed to impose penalty irrespective," Murtaza Somjee, partner at law firm Jerome Merchant + Partners told BloombergQuint.

The tribunal did not just stop there, it also penalised the resolution applicant.

While the court did not adjudicate on when and how a resolution applicant can withdraw its resolution plan, it did note that "thwarting the insolvency process" by late withdrawal will have a far-reaching effect and will deprive others of their right to participate in a corporate debtor's restructuring. To discourage such moves, the NCLT ordered that only half of the Rs 50 lakh in earnest money deposited by the resolution applicant, be returned to it.

An offer once accepted can only be rescinded or taken back if that is permitted under the terms of the resolution plan. The IBC does not permit withdrawal of resolution plan except in rare circumstances, Somjee said.

A resolution plan is after all nothing but a contract with mutually accepted terms and conditions, including termination and withdrawal. But withdrawal at the stage where only tribunal's approval is pending could push the company towards liquidation, and so this decision should have consequences, Desai said.

Both experts agreed that while overall the intent of the code is intact, this implementation is not aligned with the law's original intent. To get desired results, the code needs a careful and thorough overhaul.

Interestingly, the resolution professional had refused to allow the promoter to bid for his own company, holding that he was ineligible under section 29A. This section bars promoters of insolvent companies to participate in the resolution process. To be clear, the NCLT did frame this question to adjudicate i.e. whether an ex-director, also SBM Paper Mills' promoter, is barred under section 29A to offer a one-time settlement. But without deliberating on the contention, the tribunal noted that the ex-director wasn't a wilful defaulter at the time.

And just like that, through this one-time settlement route, the promoter reacquired control of his company — a strategy the Ruias (promoters of distressed Essar Steel) are keen to pursue as well.