

Insolvency and Bankruptcy Hotline

April 06, 2023

RECENT JUDICIAL DEVELOPMENTS - INSOLVENCY AND BANKRUPTCY CODE, 2016 - PART 2

INTRODUCTION

In Part I of the Year End Wrap ([available here](#)), we analysed some of the empirical data on recoveries and investments under the Code as well as impact of legislative/regulatory amendments on investments and acquisitions under the Code. In Part II, we have analysed some of the significant judicial pronouncements and their impact on the investor community as well as other stakeholders.

JUDICIAL DEVELOPMENTS

The year 2022 witnessed the pronouncement of crucial decisions by the NCLTs and landmark precedents by the Supreme Court on the broad themes of, inter alia, (a) treatment of contingent claims, (b) scope and extent of review by NCLTs; (c) status of personal guarantors under the Code; (d) attachment of assets of the corporate debtor post commencement of the CIRP, and (e) Awards and decrees qualifying as a valid proof of debt. Below is a short summary of such judicial developments, a detailed analysis for some of the issues is hyperlinked.

1. TREATMENT OF CONTINGENT CLAIMS UNDER IBC

With the imposition of moratorium, adjudication of disputed claims against the corporate debtor that are pending as on the date of commencement of CIRP get stalled. Thereafter, all categories of creditors are invited to submit their claims in order to prepare a consolidated liability statement of the debtor. As a part of this process, claims pending adjudication are also submitted by the respective claimants ("Contingent Claims"). In 2019, the Supreme Court, in *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*,¹ had observed that once a CIRP ends, the corporate debtor should start afresh on a 'clean slate'. It was also observed that adjudication of Contingent Claims cannot be allowed to continue post the successful completion of a CIRP. Therefore, if a claimant has pending arbitration proceedings against a debtor at the time of commencement of CIRP, the entire claim could be attributed nil value by the RP.

However, recently the Supreme Court adopted an apparently contradicting position, and allowed an arbitration proceeding to continue post the successful completion of the CIRP.² However, if legacy liabilities are allowed to continue post successful completion of a CIRP, it may disincentivise an investor-acquirer from bidding for such a debtor.

A solution may be derived from the discussion paper released by the IBBI, which identified that all 'Contingent Claims' are capable of being estimated and an liquidator must not reject them.³ This proposition was reflected in the 2018 amendment to the Code which made it mandatory for liquidators to estimate the value of contingent claims and incorporate the same in the consolidated liability statement of the debtor, such valuation being binding on all stakeholders. If the same process is adopted during a CIRP as well, it will ensure that a Contingent Claim is not attributed nil value by default, and that a successful resolution applicant has certainty and finality on the acquisition value of the corporate debtor upon approval of its resolution plan. For a detailed discussion on the subject, please refer to our article and podcast on this subject, available [here](#) and [here](#).

2. CAN PROCEEDINGS UNDER THE IBC REPLACE EXECUTION OF ARBITRAL AWARDS?

Recently, the Supreme Court in *Kotak Mahindra Bank Limited v. A. Balakrishnan*,⁴ held that once a claim has been adjudicated by a tribunal or a court, such a decree would qualify as a valid proof of debt under the IBC, and, as a result, could be used to initiate insolvency proceedings under the IBC. The Supreme Court explained that the liability arising out of an arbitral award or a court decree would be categorized as financial or operational debt depending on the nature of the underlying agreement.⁵

While an operational creditor must establish that there is no pre-existing dispute in respect of the default amount, there is no such requirement for a financial creditor. Consequently, for an arbitral award in an India-seated arbitration, an award holder which is deemed to be a financial creditor, should be able to file an insolvency application, irrespective of whether any setting aside proceedings are pending. However, if an award holder is deemed to be an operational creditor, it cannot file an insolvency application until the completion of appeal/setting aside proceedings.⁶ For further analysis on how the finality of an award/judgment/decreed would impact the position of a creditor (financial and operational), please refer to our article [here](#).

3. ATTACHMENT BY ENFORCEMENT DIRECTORATE OF A CORPORATE DEBTOR'S ASSETS

While the Prevention of Money Laundering Act, 2000 ("PMLA") and IBC are special statutes and have distinct

Research Papers

Fintech

May 05, 2025

Medical Device Industry in India

April 28, 2025

Clinical Trials and Biomedical Research in India

April 22, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India

April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Audio

CCI's Deal Value Test

February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Yyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

legislative purposes, there is an apparent conflict between the two with respect to situations regarding the attachment of assets of a corporate debtor during its CIRP. In this respect, Section 32A was inserted into the Code with the objective of (a) absolving a corporate debtor for any liability in respect of any offence committed prior to the commencement of the CIRP; and (b) protecting assets of the corporate debtor from any action in relation to such offence.

However, recently, the Delhi High Court in relation to the CIRP of Era Infra Engineering Limited, held that an attachment of the debtor's assets during the subsistence of moratorium is valid and maintainable.⁷ The court explained that while the purpose of moratorium is to prevent individual actions by creditors to recover their dues, the 'Enforcement Directorate' under the PMLA ("ED") is not akin to 'a creditor pursuing an ordinary monetary claim'. The court further stated that the PMLA seeks to subserve a larger public policy objective.

Pursuant to the above judgment of the Delhi High Court, ED can attach assets (including by way of freezing bank accounts) of a corporate debtor after the commencement of CIRP and imposition of moratorium. Such attachments might adversely impact the efficacy of the insolvency resolution process of such a corporate debtor. Since a corporate debtor is aimed to be sold as a going concern, regular cash flow is required during the CIRP for its day to day functioning. While 'CIRP costs' are paid for by the COC, the COC itself cannot infuse cash flow into the debtor. Further, the terms of raising interim finance are onerous and are generally met with resistance from the COC. In absence of adequate cash flow, the corporate debtor's ability to perform its day to day functions would be severely prejudiced. Therefore, if assets of such corporate debtors are attached by the ED during the CIRP, it will be extremely challenging to maintain the corporate debtor as a going concern till the successful completion of its CIRP.

Further, in multiple cases, the NCLTs and NCLAT have directed resolution professionals to approach special courts designated under the PMLA to seek the release of assets of a corporate debtor attached by the ED during the CIRP.⁸ If a resolution professional is compelled to approach the special court under PMLA for release of attached assets, it could result in stalling of the CIRP as well as draining of resources. The situation may worsen if a substantial portion of the assets of the corporate debtor are attached.

Further, such attachment of assets (and subsequent delay in release of the same) might restrict the ability of an RP to carry out valuation of such assets which would in turn constrain the preparation of a consolidated asset statement of the debtor. Lastly, initiation of separate proceedings before special courts to secure release of attached assets leads to multiplicity of proceedings which goes against the legislative objective of the Code.⁹ In our write up [here](#), we discuss further ramifications and possible way forward towards resolving issues arising out of attachments by ED during the CIRP.

4. DOES THE NCLT POSSESS A DISCRETION IN ADMITTING AN INSOLVENCY APPLICATION BY FINANCIAL CREDITORS

The process of adjudication by NCLT is summary in nature wherein the NCLT is required to only determine the existence of debt and default on the basis of documentary evidence brought on record by the creditor-applicant. The summary nature of insolvency applications allowed the NCLT to meet strict statutory timelines which, in turn, dissuaded the defaulting debtors from delaying repayment to creditors.¹⁰ The NCLT did not have a discretion to refuse admission of an insolvency application once a creditor proved the existence of debt and default.¹¹

However, in the recent case of Vidarbha Industries Power Limited v. Axis Bank Limited,¹² the Supreme Court has taken a view that it is not compulsory or mandatory for the NCLT to admit an application even if the existence of debt and default is proved. In Vidarbha, the corporate debtor resisted the admission of the insolvency application on the ground that there was an appeal pending against an arbitral award in its favour, the proceeds of which could be used to satisfy the dues owed to the creditor. The Supreme Court stalled the commencement of the CIRP until the disposal of the appeal.

It is possible for any debtor entity to show a possible source of funds which can be utilized to satisfy dues owed to a creditor. Possible infusion of capital, external borrowing, pending legal proceedings are all examples of such source of funds. It is almost impossible for the NCLT to carry out a qualitative as well as objective case by case analysis of the viability and availability of such source of funds. Given the massive caseload with NCLTs and limited infrastructure to deal with cases, an inquiry by NCLTs into such grounds and contentions by a debtor would further delay the process of disposal of applications and, as a result, add to the existing case load.

If insolvency applications are kept in abeyance until debtors are able to gather necessary finances to satisfy the dues of its creditors, such creditors may have to wait for years together to recover their dues. One of the basic tenets of the Code was to provide a time-bound and efficient insolvency resolution framework, which would stand defeated if the debtors are permitted to deploy such dilatory tactics. It might be necessary for the legislature/judiciary to take appropriate steps to ensure that the observations made in the Vidarbha judgment do not render the Code redundant.

5. MODIFICATION OF RESOLUTION PLANS AFTER APPROVAL BY THE COC

Investors generally incorporate clauses like 'material adverse change', 'force majeure', 'condition precedent', 'condition subsequent', etc. which would help an investor to withdraw from a potential acquisition should extraneous circumstances impact the value of assets being acquired. In the process of acquisition of stressed assets under the IBC, there is an intervening period between approval of a resolution plan by the COC and thereafter, by the NCLT. We have seen multiple instances where this intervening period has been prolonged due to extraneous circumstances like multiple rounds of litigation,¹³ and pandemic induced delays.¹⁴ During this intervening period, it is possible that (a) the assets of the debtor suffer from a substantial depreciation, and (b) the investor-acquirer obtains new information about the debtor. It is possible that the above change in circumstances could not have been ascertained by the acquirer even after a due diligence. In such situations, the investor-acquirer should have the ability to either modify or withdraw its offer to acquire the debtor.

However, the Supreme Court has recently held that NCLTs cannot allow modifications and/or withdrawals of resolution plans once such plan has been submitted to the NCLT after approval by the COC.¹⁵

In this regard, we may draw learnings from jurisdictions such as Singapore and the United States which have a

robust insolvency resolution framework. We have explored the contours of the judgment of the Supreme Court and the steps that can be taken to address the aforesaid issue in our article [here](#).

6. PERSONAL GUARANTORS CAN BE MADE LIABLE UNDER INSOLVENCY CODE PRIOR TO ANY ACTION AGAINST THE PRINCIPAL BORROWER

The Supreme Court has provided clarity on the (a) right of creditors to initiate insolvency resolution process against personal guarantors of the principal borrower; and (b) timing and jurisdiction to exercise such a right.¹⁶ Creditors can now initiate insolvency proceedings against personal guarantors even before commencing a CIRP against the principal borrower.

Since the inception of the IBC, we have seen large corporate groups undergoing CIRP. In each of these cases, multiple creditors had to take severe haircuts (even nil payment for some creditors as the amount offered by the resolution applicant could satisfy the dues of secured financial creditors only). While some creditors, including public sector banks, faced huge fiscal losses, the promoter entities/individuals continued being financially sound. This judgment will help creditors to recoup the unsatisfied claims from the personal assets of the promoters of the defaulting debtors. Please refer to our analysis [here](#) for further discussions on the implications arising out of the judgment.

7. ATTACHMENT OF ASSETS BY ED DURING LIQUIDATION PROCESS UNDER IBC

Section 32A was introduced to the Code to offer a corporate debtor indemnity from liability arising from offences committed by the erstwhile management. Under Section 32A, for an offence committed by the corporate debtor prior to CIRP, assets of the corporate debtor cannot be attached or foreclosed in the following two scenarios: (a) a resolution plan is approved by adjudicatory authority, or (b) if those assets are being sold through liquidation.

Two issues that arise are:

- (i) Identifying the trigger point of the embargo under scenario (b) above;
- (ii) Impact of such embargo on an ED investigation after moratorium under CIRP has ceased.¹⁷

The Delhi High Court in *Nitin Jain Liquidator PSL Limited v. Enforcement Directorate* through: Raju Prasad Mahawar, Assistant Director PMLA,¹⁸ held that the trigger for applicability of the statutory bar under Section 32A would be the approval of the method of sale under liquidation by the NCLT. Accordingly, once any of the measures enshrined under the Liquidation Regulations¹⁹ are adopted and approved by the NCLT, ED cannot exercise its powers under the PMLA to attach the assets of the corporate debtor.²⁰ This would imply that the ED can attach assets post completion of the CIRP, and after initiation of the liquidation proceedings.

Certain anomalies might arise as a result of Delhi High Court's interpretation of Section 32A. We have discussed these in an article which is available [here](#).

8. COC'S DECISION TO WITHDRAW INSOLVENCY PROCEEDINGS HOLDS PRIMACY

Can the NCLT review the merits of a settlement plan approved by the CoC?²¹ This issue was considered by the Supreme Court in relation to the CIRP of M/s Siva Industries and Holdings Ltd.²² The Supreme Court gave precedence and priority to the commercial wisdom of the CoC to allow withdrawal of a CIRP. Relying on an earlier judgment,²³ the court also stated that if the CoC 'unjustifiably' or 'arbitrarily' refuses withdrawal of a CIRP, then the NCLT can review and set aside such decision of the CoC.

However, a reading of the judgment implies that promoter can choose to submit a settlement proposal even at the belated stage of liquidation proceedings. Such a scenario would unnecessarily delay repayment of creditors and would also result in unnecessary wastage of resources and misutilisation of infrastructure. For detailed insight on the issues related to the judgment, please refer to our analysis [here](#).

WAY FORWARD

In [Part I](#), we had highlighted that the Code has fared better than other recovery regimes. While the statistics are encouraging, there are still concerns that the Code might be losing its sheen.

Two major issues that have plagued the effective implementation of the insolvency framework are: (a) inordinate delays in the successful completion of CIRPs, and (b) resolution applicants facing unforeseen challenges, including legacy liabilities of the debtor. We have attempted to explore these concerns and the underlying reasons.

Before a CIRP is successfully concluded, there may arise multiple judicial proceedings in relation to the CIRP. These proceedings could arise out of (a) applications filed by the resolution professional, debtor and the CoC; (b) applications filed by other stakeholders in relation to the CIRP; and (c) appeal proceedings against such applications. These applications remain pending for years due to lack of adequate infrastructure. Due to such delays, the assets and business of the debtor continue to suffer from depreciation, thereby causing incremental prejudice to an interested acquirer.

In any investment opportunity, an investor would weigh the expected rewards against risks which are either known or can be reasonably estimated. Similarly, for acquisition of stressed assets through the IBC route, the insolvency resolution mechanism should ensure that there are no unexpected 'risks' at the culmination of the resolution process. Unfortunately, we have witnessed several instances where legacy liabilities have come to haunt investors after the successful completion of the CIRP. If such a practice is not corrected, investors could be compelled to hedge their risks at the bidding stage and propose a lower acquisition price to tackle contingencies. This will in turn result in a lower realization value for creditors.

In order to strengthen the efficacy of any insolvency resolution mechanism, a robust pool of investor-acquirers is a pre-requisite. Although there have been multiple amendments to the Code to tackle evolving roadblocks, like previous recovery regimes, we are witnessing multiple cases where creditors are accepting substantially low recoveries. Without active participation from the investor community, creditors would have to liquidate most of the defaulting entities, which would involve longer timelines and increased costs.

The IBC has undoubtedly bolstered the stressed asset market in India, which demonstrates that the Code is a significant step in the right direction. Statistics show that since the inception of the Code there has been a steady increase in the percentage of realization rate prior to the Covid pandemic. In order to regain the lost momentum, it is important to restore the confidence of all investors in the insolvency framework. Therefore, a concerted effort by the legislature as well as stakeholders is required in order to address the challenges faced by the Code.

– Adimesh Lochan, Arjun Gupta & Sahil Kanuga

You can direct your queries or comments to the authors

¹ (2020) 8 SCC 531

² Fourth Dimension Solutions Ltd. v. Ricoh India Ltd. & Ors., Civil Appeal No. 5908 of 2021

³ IBBI Discussion Paper on Corporate Liquidation Process, August 26, 2020, available at <https://ibbi.gov.in/uploads/whatsnew/2020-08-26-184542-x70yo-1bc5a2ba5d43fda2a51fa372bf5bc76c.pdf>

⁴ 2022 SCC OnLine SC 706

⁵ This position has been confirmed by the Madras High Court in Cholamandalam Investment and Finance Company Ltd. Vs. Navrang Roadlines Pvt. Ltd. Through its Liquidator Mr. Sachin Dinkar Bhattbhatt.

⁶ K Kishan v. Vijay Nirman, (2018) 17 SCC 662.

⁷ Rajiv Chakraborty Resolution Professional of EEIL v. Directorate of Enforcement, 2022 SCC OnLine Del 3703

⁸ Ashok Kumar Sarawagi v. Enforcement Directorate, Government of India, (2022) ibclaw.in 337 NCLAT; Kiran Shah v. Enforcement Directorate, (2022) ibclaw.in 10 NCLAT; Varrsana Ispat Limited Vs. Deputy Director of Enforcement, [2019] ibclaw.in 67 NCLAT.

⁹ The IBC was introduced as a self-contained code to consolidate all proceedings pertaining to insolvency resolution before a single forum.

¹⁰ Please refer to Part I for empirical data and our analysis.

¹¹ As was expressly set out in Innoventive Industries Ltd. v. ICICI, (2018) 1 SCC 407

¹² (2022) 8 SCC 352

¹³ Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors.

¹⁴ Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. and Anr., (2022) 2 SCC 401.

¹⁵ Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. and Anr., (2022) 2 SCC 401.

¹⁶ Mahendra Kumar Jajodia v. State Bank of India, 2022 SCC OnLine SC 908.

¹⁷ A conjoint reading of Section 14 and Section 33(5) of the Code would imply that legal proceedings stalled during the CIRP proceedings can be re-started post the liquidation commencement date.

¹⁸ 2021 SCC OnLine Del 1255.

¹⁹ Regulation 32, IBBI (Liquidation) Regulations, 2016

²⁰ At the same time, the Court clarified that there is no bar under IBC which restrains the ED from proceeding against the erstwhile management of the corporate debtor.

²¹ Under S. 12A of the Code, an application for withdrawal can be made by promoters if a proposal for settlement is accepted by creditors.

²² Vallal RCK v M/s Siva Industries & Anr, 2022 SCC OnLine SC 756.

²³ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17.

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.