

# Insolvency and Bankruptcy Hotline

August 29, 2017

## ESSAR STEEL BANKRUPTCY SAGA: NCLT TAKES A FIRM STANCE YET AGAIN

- The National Company Law Tribunal (“NCLT”) admits the S.7<sup>i</sup> application against Essar Steel, moratorium on legal proceedings declared, and an Insolvency Resolution Professional (“IRP”) has been appointed and directed to make a public announcement;
- An order passed by the NCLT is a judicial order which should be in accordance with the provisions of the IBC and the principles of natural justice, and must take the consequences of the order into consideration;
- NCLT not bound to admit a bankruptcy application under Section 7(5)(a) of the IBC, to have discretionary powers while admitting an application;
- Essar Steel’s ongoing Debt Reconstruction Scheme not a bar to proceedings under IBC and may be taken into consideration by the Committee of Creditors.

### INTRODUCTION AND BACKGROUND

The Ahmedabad Bench of the NCLT has admitted an application for the initiation of insolvency resolution proceedings filed by State Bank of India (“SBI”) and Standard Chartered Bank (“SCB”) against Essar Steel India Limited (“Essar”).

The RBI vide its Press Note dated June 13, 2017 (“Press Note”) had identified Essar as one of the 12 accounts which had to be proceeded against in the NCLT. Following the Press Note, Essar approached the Gujarat High Court to challenge (i) the validity of the Press Note; (ii) the decision of the Consortium of Lenders to initiate action under the IBC; and (iii) the Consortium of Lender’s failure to implement the restructuring plan which had been approved by the Board of Directors of Essar. Although the Gujarat High Court stayed the proceedings in the NCLT during the pendency of the challenge proceedings, it was eventually held that the creditor-banks could proceed before the NCLT (“GHC Ruling”). Further details about the Press Note and the judgment of the Gujarat High Court can be found [here](#).

Consequently, SCB and SBI initiated a Corporate Insolvency Resolution Process (“CIRP”) under Section 7 of the Insolvency and Bankruptcy Code, 2016 (“IBC” or “Code”) in respect of Essar’s outstanding debts.

### FACTS

SCB had provided a loan to Essar’s fully owned foreign subsidiary, Essar Steel Offshore Limited (“ESOL”). Essar was a guarantor to this loan.<sup>iii</sup> Accordingly, SCB had issued a demand notice to Essar on ESOL’s failure to pay the amount due to them. Since Essar failed to respond to the demands of SCB, it sought to initiate the CIRP and proposed a name for an Interim Insolvency Resolution Professional (“IRP”).

SBI, unlike SCB, had been a part of the Joint Lenders’ Forum (“JLF”) whereby SBI had been authorized by other Banks of the JLF to file the CIRP Application. Based on JLF recommendations, SBI proposed an IRP.

Essar did not raise any objections regarding the existence of the debt. It was admitted that they were in default, but they claimed that they were not willful defaulters. Essar also contended that the application ought not to be admitted as prejudice would be caused to the company and its employees.

### ISSUES

- Whether the NCLT has any discretion to reject an application under S. 7(5)(a) of the IBC even if the criteria therein has been met by the applicants, and whether it can look at factors beyond the ones described in the section itself;
- Whether the GHC Ruling had given any special reliefs to Essar;
- Approach to be followed for appointment of IRP.

### CONTENTIONS

#### Applicant’s Contentions

- SCB argued that the word “may” in Section 7(5)(a) of the IBC ought to be read as “shall” and not a discretionary “may”. Therefore, once a financial creditor was able to satisfy the NCLT about all requirements under the Section itself, it did not have the discretion to reject an application.
- SCB and SBI contended that the GHC Ruling did not grant any special relief to Essar. Accordingly, once the NCLT was satisfied that (i) a default exists; (ii) the application is complete; and (iii) no disciplinary proceeding is pending against the proposed IRP, the application under S. 7 must be admitted.

#### Essar’s Contentions

- Essar argued that the legislature had intentionally used the expression “may” in Section 7(5)(a), which signified a discretionary power. However, in Sections 9(5) and 10(4), the relevant provisions used the expression “shall”, which signified legislative intent to differentiate between financial and operational creditors. The intention of the

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- legislature herein was to give discretion to an adjudicating authority strictly in cases involving Financial Creditors.
- Essar submitted that the GHC Ruling had directed the Adjudicatory Authority to take into consideration the Debt Reconstruction Scheme and the complex situation that arises in case of admission of the application, and whether an IRP will be equipped to manage the affairs of Essar.
  - An Adjudicatory Authority need not appoint an IRP on the same day on which the application under Sections 7, 9, or 10 is admitted. Thus, an IRP should be appointed at a later date. Essar relied on the scheme of the Code to argue that 14-days' time limit was granted for admission of an application and hence, NCLT was not bound to appoint an IRP on the same day that the application was admitted.

#### JUDGMENT

Essar did not contest the existence of their debt and default, and the NCLT rejected all their technical objections. It was also held that admission of the application and appointment of an IRP would not cause prejudice to a corporate debtor.

#### *Interpretation of Section 7(5)(a)*

It is a settled position in law that the expressions 'may' and 'shall' by themselves do not convey legislative intent. The NCLT applied these principles and the GHC Ruling to hold that it had discretionary powers and that applications ought not to be mechanically admitted. An order admitting an application would be a judicial order and hence, it would have to comply with the provisions of the IBC, principles of natural justice, and must take into consideration the consequences of the order. It is a settled position under Indian law that courts and tribunals have limited discretionary power and that courts and quasi-judicial tribunals may, in exercise of discretionary power, mould relief according to applicable facts and circumstances.<sup>iv</sup>

#### *Implications of the GHC Ruling*

Relying upon a ruling of the National Company Law Appellate Tribunal, ("NCLAT")<sup>v</sup> the NCLT observed that although they have discretion under the Code, an Adjudicatory Authority does not need to look into any factor beyond the ones mentioned in Section 7. Further, as was held by the Appellate Tribunal, an Adjudicatory Authority ordinarily does not need to consider a Restructuring Arrangement either. However, the NCLT noted that the GHC Ruling directed that it must take into consideration all relevant facts, including the Debt Restructuring Plan, in Essar's case. In that light, the NCLT considered whether Essar's Debt Resolution Process ("DRP") would make the Insolvency Resolution Process redundant.

#### *Implications of Essar's ongoing Debt Resolution Process*

The NCLT noted that the DRP could be taken into consideration by the Committee of Creditors as one of the proposed Resolution Plans. NCLT held that a DRP was not a bar to initiate CIRP. Essar's contention that when a DRP is on-going there is no need to commence a CIRP under the IBC was rejected.

#### *Appointment of an IRP*

The NCLT noted that IBC did not expressly provide for appointment of an IRP on the day when the application was admitted. NCLT also considered the object of IBC – expeditious resolution of the insolvency process and hence, deferment of the appointment was not warranted unless there were exceptional circumstances.

Further, with respect to two different suggested IRPs, it was held that the time when an application was made before the NCLT was irrelevant for these purposes. Accordingly, since (i) the JLF had spent considerable time deciding who the suggested IRP must be; and (ii) SBI's debt was of greater value than that of SCB, the IRP suggested by SBI was appointed.

#### ANALYSIS

The ruling is a pragmatic and judicious approach to resolution of applications for CIRP. The NCLT, by rejecting Essar's dilatory objections,<sup>vi</sup> has reaffirmed the object of the Code and applied sound judicial principles to admit the application. NCLT's observations on a pending DRP are helpful in providing clarity to the nature and enforceability of rights pending other resolution measures.

Additionally, NCLT's observations on the scope of the Adjudicatory Authority's discretion under S. 7(5)(a) of the Code will help creditors evaluate merit of applications in the future. While making applications, the creditors must keep in mind that (i) their application be complete under S. 7(5), (ii) the admission of their application must be justified subject to compliance with principles of natural justice, and (iii) and the consequence of the admission must be justified.

The NCLT has upheld both the spirit and the letter of the Code in holding that technical barriers must not come in the way of speedy recovery under the Code.

– Sanjika Dang, Arjun Gupta & M.S. Ananth

You can direct your queries or comments to the authors

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#### <sup>i</sup> 7. Initiation of corporate insolvency resolution process by financial creditor

(1) A financial creditor either by itself or jointly with other financial creditors may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

**Explanation.**—For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor.

(2) The financial creditor shall make an application under sub-section (1) in such form and manner and accompanied with such fee as may be prescribed.

(3) The financial creditor shall, along with the application furnish—

(a) record of the default recorded with the information utility or such other record or evidence of default as may be specified;

(b) the name of the resolution professional proposed to act as an interim resolution professional; and

(c) any other information as may be specified by the Board.

(4) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub section (2), ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor under sub-section (3).

(5) Where the Adjudicating Authority is satisfied that—

(a) a default has occurred and the application under sub-section (2) is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application; or

(b) default has not occurred or the application under sub-section (2) is incomplete or any disciplinary proceeding is pending against the

proposed resolution professional, it may, by order, reject such application:  
Provided that the Adjudicating Authority shall, before rejecting the application under clause (b) of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the Adjudicating Authority.  
(6) The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5).  
(7) The Adjudicating Authority shall communicate—  
(a) the order under clause (a) of sub-section (5) to the financial creditor and the corporate debtor;  
(b) the order under clause (b) of sub-section (5) to the financial creditor, within seven days of admission or rejection of such application, as the case may be.

<sup>ii</sup> Standard Chartered Bank Ltd. v/s Essar Steels Ltd, IA 153/2017 with C.P. (I.B) No. 39/7/NCLT/AHM/2017

<sup>iii</sup> As per facts recorded, SCB appears to be an unsecured financial creditor.

<sup>iv</sup> Hindalco Industries Ltd. v. Union of India (1994) 2 SCC 594.

<sup>v</sup> M/s. Innovative Industries Ltd. vs ICICI Bank & Anr, Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017.

<sup>vi</sup> The Tribunal shot down several of Essar's technical grounds, seemingly submitted only to delay the process- for instance, (i) SBI's authorized signatory was held to be competent; and (ii) the IRP was appointed on the same day. It is clear that the NCLT will not be easily bogged down by the creditors dilatory tendencies.

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