ESSAR STEEL INSOLVENCY CASE

Essar Steel India Limited through Authorised Signatory vs. Satish Kumar Gupta & Ors (Judgment Dated 15.11.2019 in Civil Appeal No. 8766-67 OF 2019)

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ABSTRACT:

The Judgement has paved the way for Arcelor Mittal and Nippon Steel to take over debt-laden Essar Steel. 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") ii 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.

I. BACKGROUND

SCB had provided a loan to Essar's fully owned foreign subsidiary, Essar Steel Offshore Limited ("**ESOL**"). Essar was a guarantor to this loan. 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.

In March 2019, National Company Law Tribunal (**NCLT**) approved global steel-giant ArcelorMittal's bid for Essar Steel. The Committee of Creditors (**CoC**) approved the resolution plan offered by the ArcelorMittal. Under the resolution plan, ArcelorMittal offered an advance cash payment of about ₹42,000 crore to the financial creditors and capital infusion of ₹8,000 in the next few years. However, the offer did not have much for operational creditors to Essar Steel.

In 2019, the National Company Law Appellate Tribunal (NCLAT) cleared the CoC's plan but changed the financial distribution plan by ordering an equal recovery plan for all creditors, including financial and operational creditors.

II. INSOLVENCY RESOLUTION PROCESS IN INDIA

Eligibility: Under IBC, companies (both private and public limited company) and Limited Liability Partnerships (LLP) can be considered as defaulting corporate debtors. A corporate debtor is any corporate organization which owes a debt to any person. **Default Amount:** The Insolvency and Bankruptcy Code can be triggered if there is a minimum default of Rs 1 lakh. This process can be triggered by way of filing an application before the National Company Law Tribunal (NCLT). **Resolution Initiation:** The process can be initiated by two classes of creditors which would include financial creditors and operational creditors.

Creditors: A Creditor means any person to whom a debt is owed and includes a financial creditor, an operational creditor, etc. **Financial Creditors:** The financial creditor in simple terms is the institution that provided money to the corporate entity in the form of loans, bonds etc. E.g. banks. **Operational Creditors:** An operational creditor is the entity who has a claim for providing any of the four categories to the defaulted corporate- goods, services, employment and Government dues (central govt, state or local bodies).

Appointment of Interim Resolution Professional: As soon as the matter is admitted by the NCLT, the NCLT proceeds with the appointment of an Interim Resolution Professional (IRP) who takes over the management of the defaulting debtor. **Committee of Creditors (CoC):** A committee consisting only of the financial creditors i.e. the CoC is formed by the IRP. Only operational creditors having aggregate dues of at least 10% of the total debt are invited into the meeting of CoC (Operational creditors are not a member of CoC). The operational creditors don't have any voting power.

Corporate Insolvency Resolution Process (CIRP): It includes necessary steps to revive the company such as raising fresh funds for operation, looking for new buyer to sell the company as going concern, etc. The CoC takes a decision regarding the future of the outstanding debt owed to it. The resolution plan can be implemented only if it has been approved by 66% of the creditors in the CoC **Liquidation Proceedings:** In the event a resolution plan is not submitted or not approved by the committee of creditors (COC), the CIRP process is deemed to have failed. In such a situation the liquidation proceedings commence subject to the order of the tribunal.

III. HIGHLIGHTS OF THE JUDGMENT

Jurisdiction of the Adjudicating Authority and the Appellate Tribunal: The Supreme Court has made it clear that the scope of judicial review to be exercised by the Adjudicating Authority has to be within the four

corners of Section 30(2) of the Code while the review by the Appellate Tribunal has to be confined to the grounds provided in terms of Section 32 read with Section 61(3) of the Code.

The Adjudicating Authority cannot exercise discretionary or equity jurisdiction outside Section 30(2) of the Code when it comes to a resolution plan being adjudicated upon by the Adjudicating Authority. The Supreme Court stressed that the ultimate discretion of what to pay and how much to pay each class or subclass of creditors is with the Committee of Creditors ('COC') with a caveat that the decision of the COC must reflect the fact that the COC has taken into account that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors have been taken care of.

It was observed that if nothing is to be paid to operational creditors, the minimum, being liquidation value - which in most cases would amount to nil after secured creditors have been paid - would certainly not balance the interest of all stakeholders or maximise the value of assets of a corporate debtor if it becomes impossible to continue running its business as a going concern. The judicial review by the Adjudicating Authority would further include examining whether the resolution plan as approved by the COC has met the requirements referred to in Section 30(2) and would include the judicial review that is mentioned in Section 30(2)(e) i.e. that the resolution plan does not contravene any of the provisions of the law for the time being in force, as the provisions of the Code are also provisions of law for the time being in force. If the Adjudicating Authority finds, in the facts of the case, that there is a breach of the aforesaid, it may send a resolution plan back to the COC to re-submit such a plan after satisfying the aforesaid requirements.

Differentiation Between Secured and Unsecured Creditors: The Supreme Court categorically stated that equitable treatment is only applicable to similarly situated creditors and that the aforesaid principle cannot be stretched to treating unequal equally. Equitable treatment is to be accorded to each creditor depending upon the class to which it belonged to whether secured or unsecured, financial or operational. It was further held that there is no residual jurisdiction not to approve a resolution plan on the ground that it is unfair or unjust to a class of creditors, so long as the interest of each class has been looked into and taken care of.

Validity of the Constitution of a Sub-Committee by the COC: The Supreme Court held that with regard to exercise of COC's powers on questions which have a vital bearing on the running of the business of the corporate debtor, the same shall not be delegated to any other person in terms of Section 28(1)(h). When it comes to approving a resolution plan under Section 30(4), such power also cannot be delegated to any other body as it is the COC alone that has been vested with this important business decision which it must take by itself. The Supreme Court clarified that sub-committees can be appointed for the purpose of negotiating with

resolution applicants, or for the purpose of performing other ministerial or administrative acts, provided such acts are in the ultimate analysis approved and ratified by the COC.

Extinguishment of Personal Guarantees and Undecided Claims: The Supreme Court has made clear the effect of the approval of the resolution plan on the claims of creditors who have not submitted their claims before the Resolution Professional (Hereinafter referred to as the 'RP') within the time frame provided under the Code. The Supreme Court held that Section 31(1) of the Code posits that once a resolution plan is approved by the COC it shall be binding on all stakeholders, including guarantors. The Supreme Court held that a successful resolution applicant cannot suddenly be faced with undecided claims after the resolution plan submitted by him has been accepted as this would throw into uncertainty amounts payable by a prospective resolution applicant who has successfully taken over the business of the corporate debtor. All claims must be submitted to and decided by the RP so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor.

The Appellate Authority/ National Company Law Appellate Tribunal had in its judgment also extinguished the rights of creditors against guarantees that were extended by the promoters/promoter group of the corporate debtor. The Supreme Court set aside the aforesaid decision on the ground that the same was contrary to 31(1) of the Code. Apart from the aforesaid, the guarantors of the corporate debtor argued that their rights of subrogation, which they may have if they are ordered to pay amounts guaranteed by them in the pending legal proceedings could not be extinguished by the resolution plan. The Supreme Court observed in this regard that it was difficult to accept that the part of the resolution plan which states that the claims of the guarantor on account of subrogation shall be extinguished, cannot be applied to the guarantees furnished by the erstwhile directors of the corporate debtor. However, with regard to the present case, the Supreme Court clarified that it was not stating anything, nothing which may affect the pending litigation on account of invocation of these guarantees.

Utilisation of Profits of the Corporate Debtor during CIRP to Pay Off Creditors: The Appellate Authority had held that the profits of the corporate debtor during CIRP shall be used to pay off creditors of the corporate debtor. The Supreme Court set aside the aforesaid decision on the ground that the request for proposal issued and consented to by ArcelorMittal and the COC had provided that distribution of profits made during the corporate insolvency process will not go towards payment of debts of any creditor.

Constitutional Validity of Section 4 and 6 of the Insolvency and Bankruptcy (Amendment) Act 2019: The constitutional validity of Section 4 and 6 of the Insolvency and Bankruptcy (Amendment) Act, 2019 (hereinafter referred to as the 'Amending Act, 2019') was under challenge before the Supreme Court.

Section 4 and 6 of the Amending Act, 2019 sought to introduce a mandatory timeline of 330 days for completion of CIRP, failing which, the corporate debtor would be liquidated. Section 6, on the other hand, specified the minimum payment to be made to operational creditors and dissenting financial creditors in the resolution plan. The Supreme Court observed that the time taken in legal proceedings should not harm a litigant if the tribunal itself cannot take up the litigant's case within the requisite period for no fault of the litigant and a mandatory deadline without any exception would fall foul of Article 14 and Article 19(1)(g) of the Constitution of India. Thereby, the Supreme Court while leaving section 4 of the Amending Act, 2019 otherwise intact, struck down the word "mandatorily" as being manifestly arbitrary under Article 14 of the Constitution of India and as being an excessive and unreasonable restriction on the litigant's right to carry on business under Article 19(1)(g) of the Constitution.

The effect of this declaration was clarified, and it was held that ordinarily the time taken in relation to the CIRP of the corporate debtor must be completed within the outer limit of 330 days from the insolvency commencement date, including extensions and the time taken in legal proceedings. However, on the facts of a given case, if it could be shown to the that only a short period is left for completion of the CIRP beyond 330 days, and that it would be in the interest of all stakeholders that the corporate debtor be put back on its feet instead of being sent into liquidation and that the time taken in legal proceedings is largely due to factors owing to which the fault cannot be ascribed to the litigants before the Adjudicating Authority and/or Appellate Tribunal, the delay or a large part thereof being attributable to the tardy process of the Adjudicating Authority and/or the Appellate Tribunal itself, it was held that the Adjudicating Authority and/or Appellate Tribunal may extend the time beyond 330 days. Similarly, even under the new proviso to Section 12, if by reason of all the aforesaid factors the grace period of 90 days from the date of commencement of the Amending Act of 2019 is exceeded, the Adjudicating Authority and/or Appellate Tribunal may further extend time keeping the aforesaid parameters in mind. It was stated that only in such exceptional cases, time can be extended.

With regard to Section 6 of the Amending Act of 2019, the Supreme Court held that it was is in fact a beneficial provision in favour of operational creditors and dissentient financial creditors as they are now to be paid a minimum amount in terms of the section and the computation of such minimum amount was more favourable to operational creditors while in the case of dissentient financial creditor the minimum amount provided was a sum that was not earlier payable.

With regards to the challenge to sub-clause (b) of Section 6 of the Amending Act of 2019, the Supreme Court held that the provision was merely a guideline for the COC which may be applied by the COC in arriving at a business decision as to acceptance or rejection of a resolution plan and thereby, the aforesaid provision was upheld. It was also clarified that the COC does not act in any fiduciary capacity to any group of creditors. The

COC has to take a business decision based upon ground realities by a majority, which then binds all stakeholders, including dissentient creditors. Thereby, Section 6 of the Amending Act of 2019 was upheld in its entirety.

Treatment of Disputed Claims Filed before the RP: In the instant case, the RP admitted the claim of certain creditors notionally at INR 1 on the ground that there were disputes pending before various authorities in respect of the said amounts. However, the Adjudicating Authority directed the RP to register their entire claim and the same was upheld by the Appellate Authority. The Supreme Court set aside the decision of the Appellate Authority on the ground that the RP was correct in only admitting the claim at a notional value of INR 1 due to the pendency of disputes with regard to these claims.

IV. LIKELY IMPACT OF THE JUDGEMENT

Impact on Banks: Banks will recover Rs. 42,000 crores against admitted debts of Rs. 49,473 crore- a recovery of about 85% compared to the average recovery of 53% in other resolution cases. This would help banks in boosting their capital adequacy. **Speedy Resolution:** The verdict is likely to reduce legal wrangling between financial and operational creditors and accelerate resolution process.

Foreign Investment: It will attract investors who were getting wary of the nation's bankruptcy process. India is trying to attract foreign capital to its bad loan cleanup, as it battles the worst nonperforming loan ratio among the world's major economies. **Upheld the Spirit of IBC:** The removal of mandatory 330-day deadline will facilitate resolution, the ultimate objective of the IBC. It would provide a way forward to the IBC code in India.

V. CONCLUSION

With the Supreme Court giving a go-ahead to the sale of Essar Steel, it is expected that banks will recover over 90% of their dues worth over INR 40,000 crore that the company owes them. Operational creditors are estimated to receive close to INR 1,200 crore. This should help improve the financial position of weak public sector banks and bolster profitability given that the dues owed by Essar Steel were fully written off by almost all lenders. It remains to be seen whether the government will treat this decision as the final settled position in this regard.