

## **Insolvency Resolution and the Essar Steel Judgment – A Step in the Right Direction**

(A slightly modified version of this article titled “Viva Insolvency Resolution” was published in the Economic Times on July 20, 2017.)

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When the Insolvency and Bankruptcy Code came into effect late last year, sceptics pointed out that the time bound process contemplated by the Code could easily be derailed if one of the affected parties were to file legal challenges in the High Courts, which could drag on for months. Essar Steel’s recent petition in the Gujarat High Court against the RBI and two banks provided the first high profile test case for how a court might deal with such a scenario. And it appears that the Gujarat High Court’s judgement in this case has passed the initial test.

To understand the saga behind Essar’s petition, it is worthwhile recapping the events to date. On May 22, 2017, an ordinance amending the Banking Regulation Act was approved, which gave the RBI powers to direct banking companies to initiate insolvency proceedings under the Code. The RBI subsequently issued a press release on June 13 identifying 12 debtors in default, totalling about 25% of the gross NPAs of the banking system, that would be referred for resolution under the Code. Essar Steel was one of these debtors and, following the RBI’s directive, the State Bank of India filed an application with the National Company Law Tribunal (“NCLT”) for commencing insolvency resolution proceedings against Essar under the Code. Separately, Standard Chartered Bank also initiated insolvency proceedings against Essar.

Essar’s primary challenge was to the RBI’s press release which, it alleged, unfairly discriminated against Essar by using arbitrary criteria to determine which debtors would qualify for reference under the Code. Further, Essar pointed out that the RBI had overstepped its boundaries by trying to control how the NCLT was to manage cases under the Code. Essar also challenged the ability of the State Bank of India and Standard Chartered Bank to initiate insolvency proceedings, stating, among other things, that both these banks were in restructuring discussions with Essar and that the appointment of an insolvency resolution professional would have disastrous consequences on Essar’s business.

This case does give rise to some legitimate questions on the role of the RBI in directing banks to file applications under the Code. By the RBI’s own admission, its press release of June 13 did overstep its jurisdiction, causing it to issue a corrigendum deleting the sentence from the press release which stated that “Such cases will be accorded priority by the National Company Law Tribunal.”

However, the High Court correctly dismissed the petition primarily on two considerations. First, that the ordinance amending the Banking Regulation Act permitted the RBI to direct banks to take action under the Code. Second, and more important, the High Court recognised that the banks had the right to initiate insolvency proceedings against Essar independent of the RBI directive. A proceeding under the Code may be filed by any financial creditor of a debtor in default and, as such, both the SBI and Standard Chartered had a right to initiate proceedings, regardless of whether the RBI could direct them to do so. As a result, the Court held that the insolvency proceedings would continue and be heard by the NCLT on the merits. At the same time, the Court clarified that it was not pronouncing on whether the insolvency applications against Essar should be admitted and observed that the NCLT should make this determination after giving Essar an opportunity to be heard.

The decision of the Gujarat High Court as well as the relative speed with which it decided the case sets a helpful precedent for the functioning of the Code as intended. The Code has been designed with strict timelines and objective criteria (a default of more than Rs. 1 lakh) for the NCLT to decide whether

to admit an application. Once this is done, the NCLT steps into the background and allows creditors and debtor to come up with a resolution plan under the supervision of the resolution professional.

As the Code does not stipulate any particular type of resolution plan, Essar's ongoing restructuring discussions with lenders could continue after its insolvency application is admitted by the NCLT. Essar can even submit a resolution plan to the resolution professional as a "resolution applicant" under the Code. There are, however, two crucial differences between a restructuring that takes place within the four corners of the Code and an out-of-court restructuring. First, any restructuring under the Code must be completed in 180 days (with a one-time 90 day extension in special cases), failing which the company goes into liquidation. Second, once an application is admitted under the Code, the debtor loses control of the business which is taken over by the resolution professional. This second factor is the most likely reason for Essar's strong resistance.

The Gujarat High Court's decision is, of course, only a first step in the right direction. What remains to be seen and is likely to be far more challenging is whether Essar and other cases that are admitted for insolvency resolution are able to come up with a successful resolution plan. While over 100 cases have been admitted under the Code, to date none of them has completed the corporate insolvency resolution process. This would be the next milestone under the Code to watch out for in the coming months.

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