ACUITY LAW

INSOLVENCY
LAW NEWSLETTER

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ABOUT ACUITY LAW LLP

Acuity Law LLP was founded in November 2011. Acuity Law LLP comprises of a team of young and energetic lawyers/ professionals led by Souvik Ganguly, Gautam Narayan and Deni Shah who have deep and diverse experiences in their chosen areas of practice. We advise Indian and multinational companies, funds, banks and financial institutions, founders of companies, management teams, international law firms, domestic and international investment banks, financial advisors, and government agencies in various transactions in and outside India.

Acuity Law LLP takes pride in rendering incisive legal advice taking into consideration commercial realities. Our areas of practice are divided into three departments. The Corporate practice is led by Souvik Ganguly, the Global Trade and Tax practice is led by Deni Shah and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law LLP advises on:

- Mergers and acquisitions;
- Distressed mergers and acquisitions;
- Insolvency Law;
- Private Equity and Venture Funding;
- Employment and labour laws;
- Commercial and trading arrangements; and
- Corporate Advisory

As part of the Global Trade and Tax practice, Acuity Law LLP advises on:

- Cross-border tax planning and jurisdiction analysis;
- Strategies for acquisitions, mergers, divestitures, diversification or consolidation of businesses;
- Inbound and outbound investment structuring;
- Endowment planning / wealth management strategies;
- Global Trade & Customs laws, including foreign trade policy;
- International supply chain optimization; and
- Goods & Services Tax and other Indirect taxes

As part of the Disputes practice, Acuity Law LLP advises and represents clients on domestic and cross - border:

- Civil disputes;
- Criminal law matters; and
- Arbitration matters

Acuity Law LLP actively follows legislative and policy developments in its chosen areas of practice and shares such developments with clients and friends on a regular basis.

If you want to know more about Acuity Law LLP, please visit our website acuitylaw.co.in or write to us at al@acuitylaw.co.in.

INTRODUCTION

This newsletter covers key updates about developments in insolvency law during the month of April 2021.

We have summarized the key judgments passed by the Supreme Court of India ("**SC**"), the National Company Law Appellate Tribunal ("**NCLAT**") and various benches of the National Company Law Tribunals ("**NCLT**") and the amendments in the Insolvency and Bankruptcy Code, 2016 ("**IBC**") by the Government of India. Please see below the summary of the relevant regulatory developments.

1) GOVERNMENT ROLLS OUT PRE-PACKS FOR MICRO, SMALL AND MEDIUM ENTERPRISES ("MSMEs")

Notification dated: 04 April 2021.

Summary:
Pre-packaged insolvency process ("**pre-packs**") is a restructuring plan which is agreed to by the corporate debtor and its creditors prior to any insolvency filing. Pre-packs have the advantage of being a more informal process and the possibility of resolving the financial problems of a corporate debtor in a shorter period of time. On 04 April 2021, the Government of India promulgated the IBC (Amendment) Ordinance, 2021 to allow pre-packs process for MSMEs, and the salient features of the same are enumerated below:

Who can avail pre-packs?

(i) Corporate entities classified as MSMEs under of the Micro, Small and Medium Enterprises Development Act, 2006 ("**MSMED Act**"); and
(ii) who have committed a default and where the default value is a minimum INR 1,000,000 (Indian Rupees One Million); and
(iii) who have not undergone pre-packs / completed Corporate Insolvency Resolution Process ("**CIRP**") during a period of 3 (three) years preceding the initiation date; and
(iv) against whom no liquidation order has been passed.

Who can file an application for initiating pre-packs for the eligible MSME?

An application for pre-packs can be filed by the present management of the MSME subject to;

(i) a declaration from the directors that the MSME shall file an application for initiating pre-packs within 90 (ninety) days and that the pre-pack is not being initiated to defraud any person; and
(ii) a special resolution passed by the shareholders of the MSME approving the filing of an application for initiating pre-packs; and
(iii) the financial creditors, not being its related parties and representing at least 66% in value of the financial debt, approving filing of an application for initiating pre-packs.

Time limit for completion of MSME pre-packs

Once an application for pre-packs is allowed, the NCLT will order a moratorium for a period of 120 (one hundred and twenty) days during which the entire pre-packs process must be completed. This period is divided into two phases as follows;

(i) End of 90th day - The resolution professional to submit the resolution plan, as approved by the CoC, before the NCLT. If no resolution plan is approved by the CoC, the resolution professional to file an application for termination of the pre-packs.
(ii) Next 30 (thirty) days – The NCLT to either approve or reject the resolution plan.

Approval of resolution plan

If the MSME is not a wilful defaulter or an undischarged insolvent or otherwise not barred from submitting a resolution plan under the IBC, then the MSME shall submit a base resolution plan to the resolution professional. The resolution professional shall invite prospective resolution applicants to submit a resolution plan to compete with the base resolution plan, if the CoC does not approve the base resolution plan or the base resolution plan impairs any claims owed by the MSME to the operational creditors. The CoC may vote upon and choose the more financially viable plan amongst the base resolution plan and the other resolution plans, by vote of not less than 66% of the voting shares.

Converting pre-packs into CIRP

The CoC may, at any time after the pre-packs commencement date but before the approval of resolution plan, opt to initiate a CIRP in respect of the MSME by a vote of 66% of the voting shares.

2) ONCE A RESOLUTION PLAN IS APPROVED BY THE NCLT, NO CREDITOR CAN INITIATE PROCEEDINGS TO RECOVER CLAIMS WHICH ARE NOT A PART OF THE RESOLUTION PLAN.

Matter: Ghanshyam Mishra v. Edelweiss Asset Reconstruction Company & Ors.

Order dated: 13 April 2021.

Summary:

Under the IBC, once the claims of the creditors of a Corporate Debtor are collated, the Resolution Professional invites interested parties ('**resolution applicant**") to submit their resolution plans. A committee of financial creditors ("**CoC**") votes upon and chooses the most financially viable plan and the same is placed before the NCLT seeking final sanction. The resolution plan also provides for payment of these claims. As is generally the case, these resolution plans will not provide for payment of certain claims or may provide only part-payment of all claims. The question that arose before the SC in the present case was what happens to those claims that were not part of the resolution plan and where the resolution plan mentions that all claims that have not provided for shall stand extinguished.

The SC noted that the intent behind the IBC was to permit a restructuring process where the liability of the corporate debtor is to 'reset' and the new management begins with a 'clean slate'. This allows for the revival of the business of the corporate debtor. The three-judge bench explained that the legislative intent behind the IBC will be defeated if creditors are allowed to throw surprise claims and demand the resolution applicant to honor such claims. If this is permitted, the very calculations on the basis of which the resolution applicant submits its plans would go haywire and the plan would be unworkable. Therefore, once a resolution plan is approved by the NCLT, the same will be binding on all parties including the Government, and all claims that are not a part of the resolution plan will be extinguished and no person will be entitled to initiate or continue any proceedings concerning that claim.

3) SPECTRUM IS AN INTANGIBLE ASSET THAT CAN BE SUBJECTED TO INSOLVENCY / LIQUIDATION PROCEEDINGS.

Matter: Union of India v. Vijaykumar V. Iyer

Order Dated: 13 April 2021.

Summary:

In September 2020, the SC had directed the NCLAT to decide whether sale / transfer of right to use of spectrum by a telecom company, can be allowed under the IBC. NCLAT was to consider all issues related to the sale of spectrum usage rights and adjusted gross revenue ("**AGR**") dues of bankrupt telecommunication companies ("**telcos**") such as — Reliance Communication, Aircel and Videocon.

NCLAT held that that spectrum, which is an intangible asset of telcos, can be subjected to insolvency / liquidation proceedings under the IBC. Therefore, once CIRP is triggered, the resolution professional shall monitor such an asset of the company and manage its operations. NCLAT added that as the spectrum trading is subject to clearance of dues by the seller or buyer, as the case may be, the seller or buyer in default would not qualify for transfer of license under insolvency proceedings. In other words, telcos cannot use or transfer the spectrum license under the IBC without settling government dues.

NCLAT clarified that though telcos have the right to use spectrum under the license granted to them by the Government, they cannot be said to be the owners in possession' but only in occupation of the right to use spectrum. Ownership of

spectrum belongs to the Nation (people) with the Government being its trustee. This effectively blocks the lenders of telcos from creating any charges or interest over the spectrum license, and therefore spectrum cannot be treated as a security interest by such lenders. Thus, in the opinion of the NCLAT, the Government is an operational creditor and the dues of the Government, including deferred spectrum payments would qualify as 'operational debt' and not as a 'financial debt' as the Government had contended. This means the Government has little or no chance recovering AGR dues as financial lenders get preference over the operational ones during payment of dues under IBC. However, the NCLAT cautioned that dues of the Government cannot be wiped off under bankruptcy proceedings and telcos cannot be permitted to wriggle out of their liabilities by resorting to the triggering of CIRP.

4) ENTRIES IN BALANCE SHEETS CAN AMOUNT TO ACKNOWLEDGEMENT OF DEBT

Matter: Asset Reconstruction Company ("**ARC**") v. Bishal Jaiswal

Order Dated: 15 April 2021.

Summary:
The Limitation Act, 1963 ("**LA**"), which prescribes the time-limits for filing suits, contains a provision that if an acknowledgment of liability is made in writing before the expiration of the prescribed period, then a fresh period of limitation will be computed from the time of such acknowledgment. In other words, such an acknowledgment extends the period of limitation. The LA is applicable to proceedings before the insolvency courts under the IBC.

In the present case, a company availed loans from various lenders in 2009 and was subsequently unable to repay them. The company's account was declared as a non-performing asset ("**NPA**") in 2013. Some of the lenders assigned their loans to an ARC. The ARC took possession of the assets of the company and initiated CIRP. The NCLT while admitting the company into CIRP held that the company had acknowledged the debt before the expiry of the prescribed time and accordingly, initiation of CIRP was not barred by limitation. On appeal, the NCLAT held that entries in balance sheet would not amount to acknowledgement of debt, and therefore, a fresh period of limitation would not be computed. Accordingly, the company cannot be admitted into CIRP as the application is time barred. This order was challenged before the SC.

The ARC contended a) that entries in balance sheet would be acknowledgement of debt and b) LA is applicable to CIRP and therefore, the period of limitation must be computed from date of such acknowledgement. The defendants contented that balance sheet entries were relevant only in recovery proceedings and not during a resolution process under IBC. It was also argued that since the prescribed time-period had elapsed from date of declaration as NPA, recourse to LA was not available.

Considering that the legislative intent behind IBC was not to give a new lease of life to debts which are time-barred, the SC held that the provisions of LA would be applicable under the IBC. The SC further observed that a) though the filing of a balance sheet is by compulsion of law, the acknowledgement of a debt in the balance sheet is not necessarily so, and b) it is not uncommon to have an entry in a balance sheet with notes annexed to or forming part of such balance sheet, or in the auditor's report, which must be read along with the balance sheet, indicating that such entry would not amount to an acknowledgement of debt for reasons given in the said note. Therefore, the SC held that entries in balance sheets would amount to acknowledgement of debt for the purpose of LA. Accordingly, the SC set aside the order of the NCLAT.

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