

Extent of Discretionary Power of NCLT Under Section 7 of Insolvency and Bankruptcy Code

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Abstract:

Insolvency and Bankruptcy Code, 2016 gives provides for an insolvency proceeding being initiated by a financial creditor. The recent case of Café Coffee Day and IndusInd bank gives raise to the question with the amount of discretion that the National Company Law Tribunal (NCLT) in the initial admission stage of an application. The primary aim of the article is to examine to what extend the discretionary power has been given to the NCLT in admitting application of a financial creditor under the Insolvency and Bankruptcy Code, 2016. The article further aims at understanding the difference between financial creditor and operational creditor which could enhance the understanding of the discretion in question and the recent decisions prevailing around the discretion of the tribunal.

Keyword: Insolvency and Bankruptcy Code, Corporate Insolvency Resolution Proceedings (CIRP), National Company Law Tribunal (NCLT), Financial Creditors, Operational Creditors, Corporate Debtor

1. Introduction

Ever since the death of the founder, VG Siddartha in 2019, the Café Coffee Day enterprise, the company encountered difficulties. The death was crucial as the company was heavily indebted at that time. The further aggravated when in 2023, IndusInd Bank has applied to NCLT under Section 7 of the Insolvency and Bankruptcy code, 2016. The application was taken up by the NCLT and an order was passed which directed Café Coffee Day to file a rejoinder within two weeks, that is, by 14th of September 2023. On appeal, the former director of Café Coffee Day contended that the default occurred on the period between 2020-2021, which was declared as the moratorium period by the Central Government on its circular dated 5th June, 2020. Therefore, the current application for insolvency is to be considered as invalid. Regardless of this the NCLT has approved the bankruptcy petition based on the records that there was a default of more that Rs.94 Crore and initiated the Corporate Insolvency Resolution Proceeding (CIRP). The capital market regulator Securities Exchange Board of India (SEBI) imposed a penalty of Rs.26 Crore on the company for diverting the proceeds from subsidiaries to a business connected to the promoters. It was found that funds worth Rs.3,535 Crore were diverted from seven subsidiaries to Mysore Coffee Estate Ltd., a company connected to Café Coffee Day's proprietors. The company in conclusion reported a net loss after tax at Rs.380 Crores on contrary to Rs.121 Crores during the year-over-year. The stock price of Café Coffee Day has decreased to Rs.46.91 per share (as on 27th November 2023) when compared to Rs.271 per share in 2015.

Given this background the IndusInd Bank's application for CIRP was allowed. This discretion of the NCLT to admit application by financial creditors at its discretion due to the previous orders is analysed in this

article.

2. “Satisfaction” and “may” under Section 7(5) of the Code:

On applying the rule of literal interpretation, it is conclusive that, NCLT is given complete discretion to admit any application by a financial creditor. The provision primarily states that once the adjudicating authority (NCLT) is satisfied with the evidence of unpaid debt and when there is no disciplinary proceeding pending.

However, in 2018, the division bench of the Supreme court, in the case of *Innoventive Industries Ltd., V. ICICI Bank*¹ it was observed as such:

“It is at the stage of Section 7(5), where the adjudicating authority is to be satisfied that a default has occurred, that the corporate debtor is entitled to point out that a default has not occurred in the sense that the “debt”, which may also include a disputed claim, is not due. A debt may not be due if it is not payable in law or in fact. The moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete...”.

As observed in this case the “satisfaction” is with respect to the evidence of default and not the application made by the financial creditor. The application is admitted at the discretion of the adjudicating authority but rather a mandate when such default has occurred. This observation of the Apex Court was further emphasised in the case of *Swiss Ribbons (P) Lts. v. Union of India*². It was further stated that corporate finance being the defaulters’ paradise is lost and that it is mandatory for the adjudicating authority to admit application made by a financial creditor.

This was overturned in the case of *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*³ It was held that NCLT has to exercise its discretionary power to admit an application by a financial creditor and initiate proceeding on satisfaction of the existence of the default of debt by the corporate debtor. Although the satisfaction is to be made with respect to the debt and the default in its payment, the use of the expression “may” in the Section 7(5) signifies the discretion of the adjudicating authority. The legislative intent is clear from the construction of the provision as if the legislation contained the word “shall” if the applications were to be mandatorily admitted by the adjudicating authority. It was further observed in this case that the legislator had the wisdom to use the word “may” in Section 7(5) of the Code but in Section 9(5) of the Code, which deals with CIRP by an operational creditor, the word used is “shall” in the otherwise almost identical provision relating to initiation of CIRP by an operational creditor. This signifies the intent of the legislature to make the adjudicating authority’s power under Section 7 as discretionary and under Section 9 as mandatory.

It was clarified in *Suresh Kumar Reddy v. Canara Bank*⁴ that the decision in *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.* was with respect to the facts present in that case and the observation made with

¹ *Innoventive Industries Ltd. v. ICICI Bank*, (2018) 1 SCC 407

² *Swiss Ribbons (P) Ltd. v. Union of India*, (2019) 4 SCC 17

³ *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*, (2022) 8 SCC 352

⁴ *M. Suresh Kumar Reddy v. Canara Bank*, (2023) 8 SCC 387

respect to the discretionary power in Innoventive Industries case will hold good. It was held that once the NCLT is satisfied that a default has occurred there is not much of the discretion left with the NCLT to refuse admission of the application by the financial creditor. The only ground in which the application can be rejected is that when there is a debt but it has not become due and payable. Otherwise, there is no ground to reject an application made under this provision when there is a default.

A balance was arrived at between these two contrasting views in the case of *Ashok Kumar Tyagi v. UCO Bank*⁵ where the corporate debtor had made an offer for One Time Settlement (OTS) which was countered by the creditor. For this offer there was a further counter offer by the corporate debtor which was under consideration by the creditor in the present case. The primary contention was that since the counter offer was under the consideration by the creditor and the entity being run consists of around 7000 workmen, the petition filed under Section 7 of the Code should be rejected by the tribunal by exercising its discretionary power. The tribunal held that if there is no settlement arrived at by the parties, the CIRP of would commence and the stay would be inoperative if the NCLT has pronounced any.

3. Difference between claims of an operational creditor and a financial creditor:

The primary difference is that a financial creditor who aids in any form of financial facility to the debtor and such debt has interest which is paid as a consideration for the time value of money and also includes any amount raised through investment in debentures, bonds or other forms of security. An operational creditor is any person whose debt arises out of the provision of finance for the operation of the business which includes goods and services, employment contracts or any such amount payable.

The proceeding for default against a corporate debtor for a financial creditor and an operation creditor is provided in different provisions of the Code. Section 7 covers for financial creditor as stated earlier requires such creditor to apply to NCLT with the evidence of default to initiate the resolution process. Section 8 and 9 of the Code states the for an operational creditor to initiate a proceeding, there should be notice or invoice demanding payment for the same given to the corporate debtor. The corporate debtor is required to respond within 10 days from the date of notice as provided under Section 8 of the Code. Only after the expiration of 10 days can the operational creditor file an application with the adjudicating authority. This primary difference is in existence due to the quantum given by these two creditors. It is observed that financial creditors generally lend larger sum of money as it is one of their primary functions.

The differentiation made between the two types of creditors, that is, financial creditor and operational creditor was challenged in the case of *Swiss Ribbons (P) Lts. v. Union of India*⁶ where the Supreme Court observed that, “Financial creditors generally lend finance on a term loan or for working capital that enables the corporate debtor to either set up and/or operate its business. On the other hand, contracts with operational creditors are relatable to supply of goods and services in the operation of business. Financial contracts generally involve large sums of money. By way of contrast, operational contracts have dues

⁵ *Ashok Kumar Tyagi v. UCO Bank*, Company Appeal (AT) (Insolvency) No.1323 of 2022 & I.A. No. 1417, 4291, 4221, 4340 of 2022 & 82, 314, 385, 399 & 389 of 2023

⁶ *Swiss Ribbons (P) Ltd. v. Union of India*, (2019) 4 SCC 17

whose quantum is generally less”, thus validating the difference between operational and financial creditors.

The difference between the two types of creditors of a corporate debtor further enhances the reason why the discretion so stated by the provision is to be inferred as a mandate rather than a discretion as stated earlier that once the adjudicating authority is convinced that there is a debt, the application is to be admitted as it would be prejudicial to the creditor if not so admitted as the quantum in question is a larger sum of money.

4. Financial standing of the corporate debtor:

It is to be noted that the NCLT has rejected applications made under Section 7 of the Code on the basis of financial standing of the corporate debtor. In *SBI v. Krishidhan Seeds (P) Ltd.*⁷, the tribunal kept the application abeyance for six months since the management of the corporate debtor was trying to revive the company.

In *Central Bank of India v. Simplex Infrastructures Ltd.*⁸, the Kolkata bench of the NCLT rejected the application citing the fact that there was an arbitral award in favour of the corporate debtor. Thereby rejecting the application stating the corporate debtor would be able to pay off the creditor in this case through this amount although the secured award was around Rs. 3.38 Crores but the debt default owed to the creditor was Rs. 105 Crores. An identical stance was taken by the Hyderabad bench in the case of *SREI Equipment Finance Ltd. v. Madhucon Projects Ltd.*⁹, where the tribunal ordered that if in three months the debt was still unpaid, the financial creditor can approach the NCLT. Therefore, for the three months the CIRP would be kept abeyant.

Conclusion:

The question of discretion to be exercised for admission of such application is still yet to be settled by the Supreme Court or Parliament as the judgements in this regard is subjective in nature and a more precise stance is to be taken by the Judiciary or Legislature. The proceeding in *Café Coffee Day* case was admitted by the NCLT regardless of all these egg shells around the admission of the insolvency application under Section 7 of the Code.

The preamble of The Insolvency and Bankruptcy Code is to provide balance between all the stakeholders interests which includes the creditors of a company. In the present case it can be observed that the primary difference has been sought under this act between a financial creditor and an operational creditor as the quantum of sum given to a company by the former is relatively more than the later. The discretion under the provision for admission if so, given completely to the adjudicating authority would only mean excess power on the tribunal as although there is a debt and default in payment by the corporate debtor, the tribunal decides if the CIRP should commence which puts the creditors in a disadvantageous position. In certain other cases, the tribunal has rejected applications solely based on the fact the corporate debtor is a

⁷ *SBI v. Krishidhan Seeds (P) Ltd.*, (2023) 1 SCC 209

⁸ *Central Bank of India v. Simplex Infrastructures Ltd.*, 2023 SCC OnLine NCLT 258

⁹ *Srei Equipment Finance Ltd. v. Madhucon Projects Ltd.*, 2023 SCC OnLine NCLT 259



viable entity. Such stance goes against the letter and spirit of the code as well. Therefore, to uphold the primary motive of the code as well as to enable justice and equity of such creditors the discretion for admission of such proceedings should not be given to the tribunal.