DOES THE SUPREME COURT NEED TO CLARIFY THE APPLICABILITY OF THE INCREASED INSOLVENCY THRESHOLD?

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Introduction

On March 24, 2020, an amendment in the insolvency threshold was notified by the Ministry of Corporate Affairs to increase the amount of default from 1 lakh rupees to 1 crore rupees for initiating insolvency process against corporate debtors. Since the notification, it has been interpreted differently by various benches of the National Company Law Tribunals ("**NCLT**") despite there being precedent set out by the National Company Law Appellate Tribunal ("**NCLAT**"). The article aims to determine why the notification dated March 24, 2020 ("**Notification**") has been interpreted differently by various benches, and whether it needs settling by the Supreme Court.

Whether the Notification is prospectively or retrospectively applicable?

It is settled law that any amendment to a statute, unless expressly specified, is to be applicable prospectively.[1] With respect to the Notification, the NCLAT[2] and High Court of Kerala[3] have specifically held that it is prospective in nature, since there is no intention of the legislature otherwise. Hence, the Notification is prospectively applicable.

It becomes clear that the notification becomes effective from March 24, 2020. The question then arises on whether the date of insolvency is to be considered as on the date of default, the date of demand notice or the date of application filed before the NCLT. To determine this, it would be necessary to understand the objects and reasons of the Notification.

Purpose of the Notification

The purpose of the Notification is to ensure that small and medium enterprises facing relatively smaller debts (less than INR 1 crore) are not subjected to insolvency proceedings during the lockdown or immediately thereafter. It was clear that the imposition of the lockdown would severely affect the cash flow of small and medium companies. The purpose of increasing the Notification then was to ensure that companies who operate on credit do not suddenly find themselves under insolvency, and their proprietors unable to bring their businesses back. The objects and reasons for the Notification are clear and have also been recognised by the Delhi High Court[4].

There is a counter-argument to this that creditors' interests must also be protected and defaulters should not be protected for defaults that occurred prior to the lockdown[5]. This is basis the idea that often operational creditors would also operate on credit and would have no proper way of recovering their money. However, such an argument cannot be accepted as it goes against the mandate of IBC itself.[6] The IBC prescribes that it is not meant to be used as debt recovery

proceedings but rather proceedings to resolve companies from going into insolvency, with an emphasis on attempting to revive them. Hence, the Notification does not prevent the creditor from exercising their remedies under contract or other laws to realise their debts, but only protects the corporate debtor from going into insolvency.

Whether date of default should be relevant

It is settled law that regardless of when the cause of action had arisen, it is the date of presentation of the suit before the competent court which will be considered while considering rights available to them. The NCLAT[7] and NCLT[8] with respect to the Notification have held that a party having an actionable cause of action prior to an amendment does not vest any right upon them to exercise the same remedy. Similar to the increase of pecuniary jurisdiction of a civil court, an amendment in the statute alters the available actionable right to a creditor.

The NCLAT[9] has also held that the date of default will not come into operation and it is the date on which Section 9 application is filed will be considered relevant. While the NCLT has in a few instances[10] considered the date of default while admitting Section 9 applications filed post the Notification, the primary view[11] has been to determine maintainability based on the date of filing Section 9 application.

The Supreme Court[12] decision holding that date of default shall be considered when calculating limitation for period of limitation for filing a Section 9 application under IBC can be differentiated in the present case since limitation is only relevant for the purposes of admitting a Section 9 application, not for initiation of the insolvency resolution process.

Whether date of demand notice served under section 8 of the IBC, would be relevant while considering maintainability of the petition before the adjudicating authority?

The Supreme Court[13] while deciding on the retrospective applicability of Section 10-A inserted in IBC in a view to protect corporate debtors, observed that date of making the application before the adjudicating authority for initiating the process is to be considered. This must be read in consonance with the decision of the Supreme Court in the context of home buyers initiating insolvency[14] holding that the date of presentation is to be taken into account.

It is thus clear that initiation of the corporate insolvency happens upon presentation of the application before the adjudicating authority, i.e the Section 9 Application. The purpose of the demand notice under Section 8 is to notify the corporate debtor and allow an opportunity to bring to light any existing disputes and hence, does not relate to presentation of the petition before the Court. [15]

Hence, a purposive interpretation should prohibit applications being filed against corporate debtors who have defaults of less than INR 1 crore after March 24, 2020 regardless of the date of default of demand notice served.

Does the Supreme Court need to weigh in on this issue?

Prima facie, a challenge on the grounds of Article 14 of the Constitution would not be upheld as there is a rational nexus between the object of the notification and the increase of the threshold. Given that this is an economic measure, the decision of the Supreme Court[16] while considering the constitutionality of increasing the threshold for home buyers to file for insolvency remarked that the Court will not adopt a doctrinaire approach. This would only mean that barring manifest arbitrariness or procedural irregularity, the Notification would be considered constitutional.

The author strongly believes that the Supreme Court does not need to weigh in on this issue as the Notification remains quite clear along with various NCLAT judgements interpreting it purposively. It now remains on the NCLT benches to ensure that these decisions are followed consistently.

Reference

[1] Shyam Sunder v. Ram Kumar (2001) 8 SCC 24

[2] Madhusudan Tantia v. Amit Choraria and Foseco India Limited (2020) ibclaw.in 294 NCLAT decided on 12 October 2020; Jumbo Paper Products v. Hansraj Agrofresh (2021) ibclaw.in 497 NCLAT decided on 04 October 2020.

[3] Tharakan Web Innovations Pvt. Ltd. v. National Company Law Tribunal and Ors (2022) ibclaw.in 28 HC decided on 01 February 2022.

[4] Pankaj Aggarwal v. Union of India And Ors [2020] ibclaw.in 17 HC order dated 23 June, 2020

[5] BLS Polymers Limited v. M/s RMS Power Solutions Limited (2021) ibclaw.in 407 NCLT decided on 27 July 2021; albeit the same bench considered this decision inoperable subsequently in Veer Scaffoldings v. Unipower Projects Private Limited (IB) 528/ND/2021, decided on 16 November 2021

[6] Preamble, IBC; Swiss Ribbons (P) Ltd v. Union of India [2019] ibclaw.in 03 SC, paras 27-28

[7] Desos Software Development Pvt. Ltd. v. VA Tech Wabag Ltd. CA (AT)(CH)(INS) NO. 306/2021 decided on 10 January 2022.

[8] Hari Singh v. Dynamic Aura LLP CP IB -30(PB)/2021 decided on 24 February 2021.

[9] Desos Software Development Pvt. Ltd. v. VA Tech Wabag Ltd. CA (AT)(CH)(INS) NO.306/2021 decided on 10 January 2022.

[10] Bansal Trading Company v. Periwinkle Herbals Private Limited IB-606/ND/2021 decided on 15 March 2022; IOTA Automation Pvt. Ltd. v. IOTA Automation Private Limited 2020 SCC OnLine NCLT 1467.

[11] CBRE South Asia Private Limited v. United Concepts and Solutions Private Limited (2022) ibclaw.in 02 NCLT decided on 19 January 2022; Jamuna International v. Vasan Dental Hospitals Private Limited CP(IB)/230(CHE)/2021 decided on 03 February 2022; Harmony Creative Studio v. Bohra Fashions Private Limited CP(IB)/107(AHM)/2021 decided on 11 January 2022; SS Group Private Limited v. Shiva Asphaltic Products Private Limited (2022) ibclaw.in 20 NCLT decided on 03 January 2022 amongst others.

[12] Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. [2020] ibclaw.in 16 SC.

[13] Ramesh Kymal Vs. M/s. Siemens Gamesa Renewable Power Private Limited (2021) ibclaw.in 08 SC.

[14] Manish Kumar v. Union of India, (2021) ibclaw.in 16 SC.

[15] Hari Singh v. Dynamic Aura LLP Company Petition IB -30(PB)/2021 decided on 24 February 2021.

[16] Manish Kumar v. Union of India, ((2021) ibclaw.in 16 SC.