CASE NOTE: JUDGMENT OF THE SUPREME COURT IN THE ESSAR STEEL CASE

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By a judgment dated November 15, 2019, the Supreme Court of India in the case of Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Others delivered its final verdict on the acquisition of Essar Steel India Limited under the Insolvency and Bankruptcy Code, 2016. The proceedings under the IBC in relation to the acquisition of Essar Steel lasted for more than two years and laid down precedents on several questions arising out of the then newly introduced insolvency legislation in India. This paper is a comment on this judgement. It critically analyses the decision of the Supreme Court and the impact of the judgement on insolvency law in India.

I. INTRODUCTION

By a judgment dated November 15, 2019, the Supreme Court of India ("**Supreme Court**") in the case of *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v.*

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Satish Kumar Gupta and Others[1]delivered its final verdict on the acquisition of Essar Steel India Limited ("**Essar Steel**") under the (Indian) Insolvency and Bankruptcy Code, 2016 ("**IBC**"). Essar Steel was one of India's largest steel manufacturers. Its overdue debt of about INR 55,000 crore was the largest among the companies being resolved under the IBC. Pursuant to the IBC process, a joint venture between ArcelorMittal and Nippon Steel acquired Essar Steel in December 2019. The proceedings under the IBC in relation to the acquisition of Essar Steel lasted for more than two years and laid down precedents on several questions arising out of the then newly introduced insolvency legislation in India.

II. BACKGROUND

Insolvency proceedings were initiated against Essar Steel on August 2, 2017 by an order[2] issued by the National Company Law Tribunal, Ahmedabad Bench ("**NCLT**") admitting an application filed by Standard Chartered Bank ("**Standard Chartered**") and the State Bank of India. Initially, resolution plans were submitted by ArcelorMittal India Private Limited ("**ArcelorMittal**") and Numetal Limited ("**Numetal**"), both of whom were found ineligible by the resolution professional under Section 29A of the IBC. Pursuant to a fresh invitation, a resolution plan from Vedanta Limited was also received.

In the legal proceedings that ensued, the Supreme Court by its order[3] dated October 4, 2018 declared ArcelorMittal and Numetal to be ineligible resolution applicants under Section 29A of the IBC. However, the Supreme Court granted ArcelorMittal and Numetal two weeks from the date of the judgment to pay off the non-performing assets ("**NPAs**") of their related corporate debtors to cure their ineligibility. Consequently, the committee of creditors ("**CoC**") of Essar Steel was required to reconsider and vote on the resolution plans submitted (including the plan submitted by Vedanta). If no plan had been accepted with the requisite majority by the CoC, Essar Steel would have gone into liquidation.

ArcelorMittal after having made payments in accordance with the aforementioned Supreme Court order, resubmitted its resolution plan and emerged as the successful resolution applicant for Essar Steel when its resolution plan was approved by the CoC on October 25, 2018.

A. ArcelorMittal's Resolution Plan

Under ArcelorMittal's resolution plan, the manner of distribution of funds among the secured financial creditors was left to the discretion of the CoC. The resolution plan of ArcelorMittal provided for an upfront payment of INR 42,000 crore and an equity infusion of INR 8,000 crore. Unsecured financial creditors were to be paid about 4% of their admitted claims. Operational

[1] *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others*, (2020) 8 SCC 531.
[2] *Standard Chartered Bank and another v. Essar Steel India Limited*, 2017 SCC OnLine NCLT 10751 [34].
[3] *ArcelorMittal India Private Limited v. Satish Kumar Gupta and Others* (2019) 2 SCC 1 [116].

creditors having claims of less than INR 1 crore, workmen and employees were to be paid their dues in full. Operational creditors with claims of INR 1 crore and above were not to be paid any amounts.

The plan also provided that upon payment to the financial creditors, all security documents (excluding corporate or personal guarantees provided by the erstwhile promoter group in relation to Essar Steel's loans) would be deemed to be assigned to ArcelorMittal and those documents that were not capable of being assigned were to be terminated. Further, upon approval of the resolution plan by the NCLT, all guarantees invoked prior to the effective date of the plan and claims of any guarantor on account of subrogation under such guarantee would be deemed to be extinguished. However, the rights of the financial creditors to enforce the corporate or personal guarantees against the erstwhile promoter group were to remain enforceable.

B. Proceedings before the NCLT

The NCLT by its order[4] dated March 8, 2019 conditionally approved ArcelorMittal's resolution plan. The NCLT "suggested", *inter-alia*, that to avoid discrimination, the CoC reconsider the manner of distribution of funds proposed to be paid under ArcelorMittal's resolution plan to facilitate higher recovery for the operational creditors (having claims over INR 1 crore) and Standard Chartered (a financial creditor).

The approval of ArcelorMittal's resolution plan was challenged by various parties, including Standard Chartered, several operational creditors, the suspended board of directors and former promoters of Essar Steel.

C. Proceedings before the NCLAT

The NCLAT by an interim order[5] dated March 20, 2019 had directed the CoC to convene a meeting and make a decision further to the NCLT's directions. Pursuant to such order, the CoC approved (i) *pro rata* distribution of funds to all secured financial creditors except Standard Chartered and (ii) *ex-gratia* payment of INR 1,000 crore to operational creditors having claims above INR 1 crore.

According to the CoC, Standard Chartered was differently placed from the other secured financial creditors as (i) it was not a direct lender to Essar Steel (it had been issued a guarantee by Essar Steel for an offshore subsidiary's debt); and (ii) its debt was secured by a pledge over Essar Steel's shares of the offshore subsidiary (the fair value of such shares was marginal in comparison to the debt) and not a charge over the project assets of Essar Steel. Based on the nature and value of Standard Chartered's security, the CoC proposed to pay Standard Chartered approximately INR 61 crore resulting in a 1.7% recovery.

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[4] *Standard Chartered Bank and others v. Essar Steel India Limited***,** 2019 SCC OnLine NCLT 750 [27].

[5] *Standard Chartered Bank and others v. Satish Kumar Gupta and Others*, 2019 SCC OnLine NCLAT 937.

By an order[6] dated July 4, 2019 ("**NCLAT Order**"), the NCLAT, *inter-alia,*: (i) approved ArcelorMittal's resolution plan, (ii) modified the distribution of amounts so that all creditors (secured, unsecured and operational) were treated at par[7] (resulting in approximately 60.7% recovery for all the creditors), (iii) increased the admitted claims of operational creditors to almost four times the original amount, (iv) granted operational creditors, whose claims had not been admitted by the NCLT or the NCLAT, the liberty to institute or continue appropriate proceedings against Essar Steel after the conclusion of its insolvency resolution process, and (v) held that the guarantees issued in respect of Essar Steel's debt come to an end upon clearance of the underlying debt.[8]

D. Developments in the law

Appeals were filed before the Supreme Court challenging various aspects of the NCLAT Order, including the role of the CoC, and the scope of jurisdiction of the NCLT and NCLAT. While these appeals were pending, the Insolvency and Bankruptcy Code (Amendment) Act, 2019 dated August 6, 2019 (the "**IBC Amendment Act**") was introduced with retrospective effect. The IBC Amendment Act included provisions which directly related to the issues under consideration in this matter and therefore, the Supreme Court also heard the writ petitions challenging these provisions along with the challenges to the NCLAT Order.

The IBC Amendment Act provided that (i) the minimum payment to operational creditors under a resolution plan should be the higher of the two amounts; the amount that would be payable to them in the event of liquidation and the amount payable to such creditors if the resolution amount was distributed in accordance with Section 53 of the IBC,[9] (ii) any dissenting financial creditors should be paid a minimum of the amount that would be payable to them in the event of liquidation, and (iii) the committee of creditors may approve a resolution plan after considering the manner of distribution of funds under the plan, taking into account the respective priority of creditors under Section 53(1) of the IBC (including the priority and value of security of a secured creditor). An explanation to Section 30(2)(b) of the IBC was also introduced, which expressly clarified that a distribution in accordance with such section would be considered "fair and equitable".

Further, the IBC Amendment Act also required all corporate insolvency resolution processes to be "mandatorily" completed within a period of 330 days from the insolvency commencement date. For the resolution processes that were already underway (including those subject to litigation) a grace period of 90 days from commencement of this IBC Amendment Act was granted.

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[6] *Standard Chartered Bank and others v. Satish Kumar Gupta and Others*, 2019 SCC OnLine NCLAT 388.

[7] The NCLAT determined that security and security interests of the creditors were irrelevant at the stage of resolution for purposes of allocation of payments.

[8] Accordingly, the NCLAT held that the question of the right of subrogation and the right to indemnification (under Indian contract law) of the erstwhile promoter group who had provided such guarantees would not arise at all.

[9] Insolvency and Bankruptcy Code 2016, s 53. It provides the order of priority in which the proceeds from the sale of the liquidation assets are required to be distributed.

III. THE VERDICT OF THE SUPREME COURT

By way of the judgment dated November 15, 2019 ("**SC Judgment**"), the Supreme Court laid down several important precedents in relation to Indian insolvency laws. The decision of the Supreme Court on the issues arising in this matter were driven by certain fundamental principles in line with the objectives of the IBC. This note identifies such basic principles and then briefly summarizes the decision in the SC Judgment on each issue.

A. The Indian insolvency law favors a market and creditor driven process

The Corporate Insolvency Resolution Process ("**CIRP**") under the IBC is based on a flexible model where market participants (as resolution applicants) can propose solutions for revival of the corporate debtor. The Supreme Court made it clear that the CoC is in the driver's seat for directing the insolvency resolution process. The underlying assumption was that the financial creditors are fully informed about the viability of the corporate debtor and feasibility of any proposed resolution plan. This assumption is based on the fact that financial creditors being in the business of money-lending, having undertaken a detailed study and exercising due diligence while granting the loan to the corporate debtor, are well placed to make such assessment. Reiterating the ratio in the *K. Sashidhar v. Indian Overseas Bank*[10]the Supreme Court observed – "*… it is the commercial wisdom of this majority of creditors, which is to determine, through negotiation with the prospective resolution applicant, as to how and in what manner the corporate resolution process is to take place*."[11]

The Supreme Court held that while the ultimate business decision lies with the CoC, such decision should indicate adequate consideration of the objectives of the IBC. Accordingly, the Adjudicating Authority should ensure that the decision of the CoC takes into account the following factors: (i) the corporate debtor should continue as a going concern during the resolution process, (ii) value of assets of the corporate debtor should be maximized, and (iii) interests of all stakeholders should be balanced. In the event that the Adjudicating Authority, on a review of the facts of the case, concludes that the aforesaid factors have not been considered, it may send the resolution plan back to the CoC (but not alter the resolution plan of its own accord).

More recently, the Supreme Court in *The Karad Urban Cooperative Bank Ltd. V. Swwapnil Bhingardevay and Ors*[12] while reiterating the same principle observed that – "*If all the factors that need to be taken into account for determining whether or not the corporate debtor can be kept running as a going concern have been placed before the Committee of Creditors and the CoC has taken a conscious decision to approve the resolution plan, then the adjudicating authority will have to switch over to the hands off mode…".* Therefore, while it appears that a decision of the CoC may be challenged on the basis that relevant information or all necessary factors were not

[10] 2019 SCC OnLine SC 257.

[11] *Committee of Creditors of Essar Steel India Limited (through authorized signatory*) *v. Satish Kumar Gupta and Others*, (2020) 8 SCC 531 [62], [64].

[12] *The Karad Urban Cooperative Bank Ltd. v. Swwapnil Bhingardevay and Ors.*, AIR 2020 SC 4381 [14].

considered by the CoC, it remains uncertain how a party seeking to challenge the decision of the CoC would provide the necessary evidence to make such a case.

The Supreme Court while discussing the role of resolution applicants, stressed the importance of the right of the resolution applicant to receive complete information about the corporate debtor. In the same vein, the Supreme Court, while understanding the need for extensive negotiations with the prospective resolution applicants, upheld the right of the CoC to form sub-committees for negotiating and performing other ministerial/administrative tasks, provided that the ultimate decision/analysis was approved by the entire CoC. This would be necessary given that the most important management and business decisions in respect of the corporate debtor would be taken by the CoC.

Similarly, the Supreme Court held that the decision to allow ArcelorMittal to reduce its offer made before the court was a consequence of the negotiations by the CoC and could not be faulted by the court. The Supreme Court while upholding the supremacy of the creditors in deciding the viability of a resolution plan, including the manner of distribution under the plan, also recognized that the committee of creditors does not owe any fiduciary duty to any group of creditors but is required to take a business decision with the requisite majority, which binds all stakeholders including any dissenting creditor.

B. Equitable treatment of all creditors

Overturning the NCLAT Order, the Supreme Court held that the principle of "equality" could not be interpreted to mean that all creditors (irrespective of their security interest or their status as operational or financial creditor) should get equal recovery under a resolution plan.

The Supreme Court further held that even within a class of secured financial creditors, differential treatment based on the value of security of such creditors would be permissible. The Supreme Court observed that if the security interest of the creditors was disregarded during the CIRP, many creditors would be incentivized to vote for liquidation rather than resolution. This would defeat the key objective of the IBC, i.e. to ensure resolution of the distressed asset. Further, any bankruptcy law which delays, weakens or de-prioritizes security on insolvency, would destroy the purpose of creation of security in the first place.

The Supreme Court noted that financial creditors and operational creditors by virtue of their business relations with the corporate debtor can never be equally placed and that the IBC itself contemplates operational creditors as a separate class of creditors. However, the IBC provides for certain safeguards, such as priority in repayment to ensure the fair and equitable dealing of such operational creditors' rights. Therefore, the Supreme Court held that as long as the provisions of the IBC were complied with, the CoC could approve and even negotiate for a resolution plan which provided for differential payment to financial and operational creditors.

The Supreme Court while upholding the supremacy of the CoC in deciding the distribution among the various classes of creditors held that such financial creditors are required to also protect the interest of the operational creditors. However, there is an inherent conflict of interest as lenders are primarily motivated to ensure maximum recovery for themselves. The checks imposed on the

committee of creditors by the Supreme Court as mentioned above may be insufficient to negate such conflict of interest. Perhaps, recognizing this issue, the Report of the Insolvency Law Committee (February 2020) noted that in due course of time it may be assessed if operational creditors should be given voting rights in the committee of creditors.

C. Ensuring a fresh start for the resolution applicant

Relying on the principle that a prospective resolution applicant would need to know the total debt of the corporate debtor before acquiring it and should be allowed to start the business of the corporate debtor on a "fresh slate", the Supreme Court upheld the provision in ArcelorMittal's resolution plan which required that there would be no right to subrogation in respect of any amounts paid by the erstwhile promoter group under the guarantees extended for Essar Steel. While the claims of guarantors on account of right of subrogation stood extinguished, the Supreme Court did not opine on the merits of the pending litigation proceedings arising from invocation of guarantees provided by the erstwhile promoters/promoter group of Essar Steel.

The Supreme Court in arriving at its decision on the question of extinguishment of the right to subrogation relied on the decision in *State Bank of India* v. *Ramakrishnan.*[13] The Supreme Court, in that case, while holding that personal guarantors would be outside the purview of the moratorium under Section 14 of the IBC, relied on, *inter-alia*, Section 31 of the IBC. The Supreme Court opined that Section 31 of the IBC binds even guarantors of the corporate debtor as the approved resolution plan could provide for payments to be made by such guarantors as well.

Based on the same principle of providing the successful resolution applicant a "fresh slate", the Supreme Court also held that all "undecided" claims of the corporate debtor would stand extinguished once a resolution plan was accepted. Therefore, no creditor may pursue any claims against the corporate debtor after the completion of the CIRP.

The concept of extinguishment of liability for past criminal offences has now been statutorily implemented by the introduction of Section 32A in the IBC. This provision provides for immunity from liability to the corporate debtor and its assets for offences committed by the erstwhile management of the corporate debtor, prior to initiation of the insolvency proceeding, subject to certain conditions. Recently, the Supreme Court in *Manish Kumar v. Union of India*[14] while recognizing the importance for the new management "*to make a clean break with the past and start on a clean slate*", has rejected the challenge to the constitutional validity of Section 32A of the IBC.

[13] *State Bank of India v. Ramakrishnan,* (2018) 17 SCC 394 [25], [26].
[14] *Manish Kumar v. Union of India,* 2021 SCC OnLine SC 30 [280], [282].

D. The need for expediency in the insolvency resolution process

The Supreme Court recognized that the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debts Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 failed in resolution of stressed assets due to the legal proceedings under these legislations being dragged on for years. Therefore, to ensure maximization of realization of value of the assets of the stressed company in line with the objectives of the IBC, the Supreme Court did not consider it fit to strike down Section 4 of the IBC Amendment Act which provided for a mandatory timeline within which the CIRP (including legal proceedings) needed to be completed.

Instead, the Supreme Court read down such provision by striking down the word "mandatorily" before the stated timeline to ensure its constitutional validity. Therefore, the CIRP should ordinarily be completed within the prescribed 330-day timeline. Further, the Adjudicating Authority may provide exemptions in certain exceptional cases where the failure to adhere to such timelines could not be attributed to any fault of the relevant litigants.

E. The resolution professional does not have an adjudicatory function

The Supreme Court discussed at length the role and responsibilities of a resolution professional to demonstrate how the resolution professional forms the procedural backbone of the entire CIRP. The Supreme Court unequivocally stated that the resolution professional is only required to collect, collate and admit claims without adopting an adjudicatory role. These claims are required to be finally negotiated and decided by the CoC.

While in theory restricting the resolution professional to a non-adjudicatory function sounds feasible, in practice this may present difficulties. The admission and rejections of creditors' claims may not always be straightforward and often involves legal questions requiring a *prima facie* evaluation of the merits of the claim. Therefore, it is not surprising that various creditors (especially operational creditors) have challenged the treatment of their claims before the NCLT, NCLAT and the Supreme Court in this matter itself. This question becomes even more relevant now that the judicial for a have to operate within the timeline of 330 days.

This anomaly is accentuated by the Supreme Court's earlier judgment in *Swiss Ribbons Pvt. Ltd. v. Union of India*[15], where the Supreme Court recognized that while the resolution professional has a merely administrative role, the determination by a liquidator under Section 41 of the IBC is of 'quasi-judicial' nature. Notably, there is no difference in the qualifications for appointment as a liquidator or a resolution professional.

[15] *Swiss Ribbons Pvt. Ltd. v. Union of India*, AIR 2019 SC 739 [90], [91].

IV. CONCLUSION

In the authors' view, the Supreme Court correctly reinforced the supremacy of the financial creditors in decisions relating to the assets, liabilities and business of the corporate debtor (including the distribution of proceeds among creditors), and clarified the narrow confines within which courts may interfere. The Supreme Court also correctly applied the "equality among equals" doctrine by appreciating the difference between financial and operational creditors, and secured and unsecured creditors. The NCLAT Order, if it had been upheld, would have resulted in catastrophic consequences on the Indian banking sector, including more stressed assets being sent for liquidation as opposed to resolution through the CIRP.

The Supreme Court's ruling on extinguishment of all past claims (including undecided claims) also brings much respite to resolution applicants, who may otherwise have been unwilling to invest in insolvent companies under the IBC due to the threat of unknown and prolonged litigation proceedings continuing even after acquisition. Further, by emphasizing on the need for timely resolution (ordinarily within 330 days) the Supreme Court has sought to address the issues which plagued the preceding regulations governing resolution of stressed assets. In the view of the authors, the SC Judgment is consistent with the economic and financial foundational principles of the banking sector and has provided an efficient means of resolution by way of the CIRP under the IBC.

However, the Supreme Court did not take the opportunity to opine conclusively on the issue of permissibility of invocation of guarantees against the erstwhile promoters of a corporate debtor pursuant to acquisition of the corporate debtor by a successful resolution applicant. A separate judgment of the Supreme Court will be needed on that issue.