USING THE IBC AS A DEBT RECOVERY TOOL: OBLITERATING THE SPIRIT OF THE LAW

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The Insolvency and Bankruptcy Code, 2016, was enacted as one of the most important pieces of economic legislations dealing with reorganisation and insolvency resolution in a time bound manner for maximisation of assets. However, the IBC has fallen prey to individual debtors using it as a tool to recover debt owed under a contract. In doing so, they are substituting the Code for other legally appointed debt enforcement mechanisms such as forums under the SARFAESI Act, 2002, and RDDBFI Act, 1993, as well as money suits. While the IBC appears to discourage such actions in its spirit and overarching purpose, there is no express bar on the same in the text. Calculating creditors are taking advantage of such an omission by using insolvency proceedings to coerce a debtor to pay. Employing insolvency as an alternative for debt collection mechanisms brings illegitimate applications before the NCLT and NCLAT at a time when lack of judicial infrastructure and delayed judgments are plaguing the IBC framework. While courts and tribunals have recognized and discouraged this kind of initiation of insolvency proceedings, the absence of an explicit disbarment on the same is a glaring lacuna in the law. This article explores the problem of using the IBC as an alternative for a debt recovery forum and argues that amending an existing provision in the IBC, i.e., Section 65, can resolve the setback that the law is facing. Section 65 penalizes malicious initiation of proceedings that are not for resolution or liquidation. By unambiguously including debt recovery actions within the ambit of malicious initiation of proceedings, the IBC will be made to operate only in its relevant domain, i.e., insolvency resolution in a time bound manner for maximization of assets.

I. INTRODUCTION

In 2014, a World Bank report estimated that it takes four years to resolve insolvency in India as opposed to one year in the United Kingdom ('UK') and ten months in Singapore.[1] Researchers have further compared the status of cases pending under India's Sick Industrial Companies Act, 1985, to the corporate insolvency cases filed in the UK, finding that there has been a considerably higher turnover in the cases which have cleared the insolvency resolution process in the UK.[2] The rationale for the same may be traced to the absence of a robust framework that would come to the rescue of the creditors in the circumstances of a default. Even though laws like RDDBFI and

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[1] Bankruptcy Law Reforms Committee, *The Report of the Bankruptcy Law Reforms Committee Volume 1: Rationale and Design*, at Ch 3.3.1 (4th November, 2015).

[2] *Ibid.*

SARFAESI existed, the persisting conditions made the creditors averse to lending.[3] To make matters worse, under this earlier framework, when the lender finally reached the stage of recuperation, they were able to regain merely 20% of the debt value, on average.[4] It was in this backdrop that the Insolvency and Bankruptcy Code ('IBC' or 'Code') was enacted in 2016 to resolve insolvency and bankruptcy more efficiently. The Code was introduced with a three-fold objective—ensuring a lower time period for resolution, securing lower losses in recovery leading to increased debt financing through diverse debt instruments to infuse capital and promotion of entrepreneurship in India.[5]

The Preamble of the IBC is carefully worded to describe the core purpose of the law to be 'reorganisation' and insolvency 'resolution', omitting the word 'recovery'.[6] Thus, the Parliament made a conscious effort to ensure that the fine line of difference between 'resolution' 'and recovery' is not blurred. While the former term entails assessing the viability of the business collectively and restructuring it if the situation permits, the latter is concerned with enforcing a specific contract and is an individual action. The fact that judgments under the IBC have tried to prohibit recovery[7] is in consonance with the purpose of the Code, which was born because pre-existing laws like the SARFAESI and the RDDBFI gave rights only to banks. Scattered masses of individuals and financial entities that purchased corporate bonds were left without a remedy as they were not covered under any vigorous framework.[8] As a result, the IBC aimed to ease collective action rather than focus on individual debt enforcement.

Unfortunately, a 'one size fits all' approach is being taken by creditors who are applying to initiate a Corporate Insolvency Resolution Process ('CIRP') simply to recover individual debt due to them under a contract, thereby misusing the provisions of the Code. There are many reasons why creditors would prefer to use the IBC against defaulters. Firstly, a CIRP is cheaper to initiate.[9] The fee for an operational creditor is a mere two thousand rupees whereas filing an ordinary suit for recovery would depend on the value of debt. Secondly, the time period for resolution is statutorily prescribed under the IBC, unlike an ordinary suit where a judgment could take years

[3] *Id.* at Ch 2.
[4] *Ibid.*
[5] *Id.* at Ch 3.4.1.
[6] Insolvency and Bankruptcy Code (Act No. 31/2016) (India), Preamble.
[7] Transmission Corp. of AP Ltd v Equipment Conductors and Cables Ltd, SCC OnLine SC 2113 (2018); K. Kishan v. Vijay Nirman Co. Pvt. Ltd., SCC OnLine SC 1665 (2017).
[8] *Supra* note 3.
[9] Sumant Batra, *Insolvency Law Not a Debt Recovery Tool*, FINANCIAL EXPRESS (June. 19, 2017), https://www.financialexpress.com/opinion/insolvency-law-not-a-debt-recovery-tool/725216/.

and the debtor through utilisation of the appeals mechanism can further delay the execution of the same.[10] Finally, the threat of tainting the debtor's reputation and business prospects with a CIRP may operate as a coercive tactic to compel the debtor to repay the creditor.[11]

This note proposes to examine this problem, taking into account the absence of bar on individual recovery in the Code, even though tribunals and courts have tried to disbar applications that seek debt enforcement. It also aims to propose solutions for making the law operate only in its designated realm, i.e., for the purposes of assessing viability of entities and aiding their resolution. By bridging this apparent gap in the provisions of the Code, it is posited that the IBC can be utilised in an optimal manner.

II. ENDEAVOUR BY COURTS AND TRIBUNALS TO UPHOLD THE ETHOS OF THE IBC

Even though there is no express bar in the IBC on using the CIRP just to recover debt owed under a contract, the National Company Law Tribunal ('NCLT'), National Company Law Appellate Tribunal ('NCLAT') and the courts have made a conscious effort to uphold the fundamental intent of the IBC, i.e., maximising the value of entities in the process of resolution. The Supreme Court has been at the forefront of disallowing applications that seek to misuse the provisions of the Code in a manner that gives them an easy way out of using the correct forums of debt recovery. Evidently, the appropriate forums in this regard are mechanisms under SARFAESI and RDDBFI as well as money suits.

Section 9(5)(ii)(d) of the IBC, which prohibits CIRP applications in cases of a pre-existing dispute between the operational creditor and the corporate debtor, has often emerged to be a helpful tool to weed out actions by operational creditors that are purely for debt recovery.[12] This is due to the fact that a history of pre-existing dispute and pending adjudication is an indicator that the IBC is being used as a means for faster recovery. Whilst being entangled in a web of litigation, this may serve to provide a degree of validation to the creditor's claim.

Such an approach was taken in *Transmission Corporation of AP Ltd. v. Equipment Conductors and Cables Ltd.,* where the petitioner and respondent had a contract relating to the supply of goods and

[10] *Ibid.*
[11] *Ibid.*
[12] Insolvency and Bankruptcy Code (Act No. 31/2016) (India), §9(5)(ii)(d).

services.[13] A dispute arose between them during the performance of the contract, which was referred to arbitration. The Arbitral Tribunal rejected the claims that pertained to certain invoices as the same had become time barred. The respondent was not successful in its challenge to the award. Thereafter, an attempt was made to recover the amount through an execution petition filed in the Civil Court, Hyderabad. Being unable to get an order in their favour even at that forum, a notice was issued by the respondent under Section 8 of the IBC as an operational creditor, arraigning the petitioner as the corporate debtor.

Despite the petitioner specifically refuting this claim in their reply, a Section 9 application was filed before the NCLT, Hyderabad which was dismissed on the grounds that the ensuing litigation between the parties qualified as a pre-existing dispute which bars the NCLT from admitting an application under Section 9. The same was upheld on appeal to the NCLAT. The Supreme Court agreed with the view of the NCLT and the NCLAT. In the context of debt recovery by the appellants, first through the arbitral council, then the civil court and finally, the NCLT, the Apex Court made two observations. First, pending litigation is an evidence of pre-existing dispute and second, when recovery through other means has been unsuccessful, the IBC cannot be used as an alternative for a debt recovery forum.[14]

In this regard, the Court cited the judgment of *Mobilox Innovations Private Ltd. v. Kirusa Software Pvt. Ltd.,* which has been instrumental in elucidating the background of the IBC, thereby clarifying the intent with which it was enacted.[15] With reference to applications filed under Section 9 by operational creditors for the commencement of CIRP, the Supreme Court examined the UN Legislative Guide on Insolvency, in which the IBC finds its roots.[16]

The Guide has referred to various instances in which an application to commence proceedings can be denied, out of which, two important circumstances relevant for the purposes of this note find a prominent mention. First, when the creditor is using insolvency as an inappropriate substitute for debt recovery procedures and second, when by initiating proceedings merely for recovering an amount due, a viable business is put on the path of being pushed out of the marketplace. As per the Guide, these situations, among others, qualify as *"improper use of the insolvency*

[13] Transmission Corp. of AP Ltd v Equipment Conductors and Cables Ltd, SCC OnLine SC 2113, 4 (2018).
[14] *Id.,* at 15.
[15] Mobilox Innovations Private Ltd. v. Kirusa Software Pvt. Ltd., SCC 353 (2018).
[16] *Id.,* at 8.

proceedings".[17] Since the IBC, as it stands today, has been modeled after the UN Legislative Guide on Insolvency, it may be safe to assume that Section 9 would only encourage 'proper use' of the proceedings to uphold the overarching sentiment of the Guide.

Applying the ratio of Mobilox, the Supreme Court in *K. Kishan v. Vijay Nirman Co. Pvt. Ltd.* also reached a similar conclusion.[18] In this case, an arbitral award of two lakh rupees was challenged while a Section 9 application for CIRP was filed in the same period.[19] According to the Court, the challenge fell within the ambit of a pre-existing dispute as envisaged by the Code.[20] In addition to the disqualification of pre-existing dispute, it was also observed by the Court that the Code could not be used prematurely or as a substitute for debt enforcement procedures.[21] The recovery of an amount as small as two lakh rupees, it was said, could not be a good enough reason to threaten a company that was otherwise solvent and valued at several crores.[22]

Reiterating the aim of the Code, it was held that its provisions cannot be used to extract the sum of money owed, more so when it may not even be finally payable as adjudication proceedings in that regard were still pending.[23] In doing so, it was once again categorically clarified that the insolvency process cannot be used to bypass debt adjudicatory and enforcement procedures that have been outlined in other relevant statutes.[24]

This brings to light another important concern with using the IBC purely for the purposes of debt recovery, particularly when the amounts due are small. The worry being that if the company is a solvent entity and is worth much more than the owed amount, the entire manpower and time that is invested if CIRP is allowed becomes futile as the company is evidently a viable and going concern. In such cases, the question of reorganisation or resolution of the company does not arise.

Apart from the Supreme Court, the NCLAT has also played a proactive role in recognising and disbarring improper applications that do not resonate with the ethos of the Code. In *Binani Industries v. Bank of Baroda,* the issues before the NCLAT surrounded the Resolution Plan of Rajputana Properties Limited and whether this plan was in contravention to the provisions of the

[17] *Id.*, at 10.
[18] K. Kishan v. Vijay Nirman Co. Pvt. Ltd, SCC OnLine SC 1665 (2017).
[19] *Id.*, at 2.
[20] *Id.*, at 6.
[21] *Id.*, at 8.
[22] *Id.*, at 13.
[23] *Ibid.*
[24] *Id.*, at 17.

IBC.[25] In order to decide this issue, the Tribunal pondered over the exact nature of a Resolution Plan and what it seeks to achieve.

It noted that an ideal resolution plan read with the objectives of the Code should resolve insolvency, maximise the value of the corporate debtor's assets and promote entrepreneurship, but it should not be in the form of a recovery.[26] The NCLAT differentiated between recovery and resolution, in as much as recovery is an individual effort by the creditor to recover its debt in a process that places the debtor and creditor on opposite sides. This is to be viewed as opposed to the collective deliberation of the creditors and debtors together in the Committee of Creditors during resolution. Even otherwise, recovery strips the corporate debtor of its assets while a resolution is an effort to keep it afloat.[27]

III. IS USING THE IBC PROCEDURE FOR DEBT RECOVERY 'MALICIOUS'?

Even though it is now understood that the spirit of the Code is to discourage recovery, it does not contain any explicit provisions to that extent. This may lead to inconsistencies in the application of the law. Additionally, those who are not well versed with the scheme of the Code and its overarching sentiment may continue to file inappropriate applications or take advantage of the fact that there is no provision in black and white that disbars recovery. In any case, codifying such a disqualification in express terms may provide more legitimacy to courts' denial to commence CIRP proceedings on this ground.

The provision that comes closest to discouraging usage of the Code as a debt recovery mechanism, albeit in implied terms, is Section 65(1) of the IBC. Section 65 prescribes a penalty for those who initiate the CIRP or liquidation fraudulently or with a malicious intent.[28] This Section goes on further to describe what might qualify as fraudulent or malicious, i.e., when an application for CIRP or liquidation proceedings is filed *for any purpose apart from resolution of insolvency or liquidation.*[29] This implies that an application filed for the purpose of 'recovery' will be covered within the scope of malicious initiation of proceedings. Apart from this construction of the Section, the ruling in a 1957 Madras High Court case that elaborates on the meaning of the word

[25] Binani Industries v. Bank of Baroda, (2018) CA (AT) (Insolvency) No. 82, 15.
[26] *Id.*, at 17.
[27] *Ibid.*
[28] Insolvency and Bankruptcy Code (Act No. 31/2016) (India), §65(2).
[29] Insolvency and Bankruptcy Code (Act No. 31/2016) (India), §65(1).

'malice' also leads us to the same conclusion. The Court in *S.T. Sahib v. Hassan Ghani Sahib*[30] held malice to mean the existence of some *"improper" and "wrongful motive"* to use the legal process in a manner other than its *"legally appointed and appropriate purpose"*. Further, the High Court stated that usage of wrongful motive in this context need not be rooted in animosity or *mala fide*; it could simply be an attempt to attain a collateral advantage.[31]

The case laws on Section 65(1) in the short history of the Code have not yet dealt with a situation where recovery of debt has been claimed to fall under the ambit of Section 65, though it may not be a stretch to treat this provision as an appropriate means to disbar such applications.

The NCLAT judgment in *Asset Advisory Services v. VSS Projects* may be a good example to show how Section 65 has been applied in the past.[32] The Tribunal reiterated that anyone who is initiating the CIRP for any other purpose apart from resolving insolvency is actually misusing the provisions of the IBC. In the present case, the financial creditor had lent a short-term loan of rupees two crore to the corporate debtor and three flats belonging to the latter had been mortgaged for the same.[33] When the corporate debtor attempted to sell these flats, the financial creditor managed to obtain a *status quo* order that prevented the sale of any flat. It also refused to accept registration of the flat in its favour. Instead, an application for initiation of CIRP was filed with the competent authority. The underlying motive for engaging in these tactics was to somehow get an insolvency professional appointed so that there would be a compulsion for distress sale of all the other flats of the corporate debtor that would amount to a whopping rupees ten crores to satisfy a meager debt of rupees two and a half crores.[34]

As is the case generally with applications filed for mere recovery of debt, in this case too, the NCLT found that it would be premature to take the corporate debtor to be insolvent or bankrupt and initiate CIRP against it.[35] Evidently, it would be even more absurd to depict the corporate debtor in such a light considering that the net worth of the debtor was much in excess of the amount payable to the financial creditor.[36] In view of the fact that there was no insolvency in the case, the Tribunal found it untenable to start the process of insolvency resolution.[37] Thus, it held

[30] S.T. Sahib v. Hassan Ghani Sahib, AIR 646, 656 (Mad.: 1957).
[31] *Ibid.*
[32] Asset Advisory Services v. VSS Projects, CP (IB) No. 96/7/HDB (2017).
[33] *Id.*, at 2.
[34] *Id.*, at 3.
[35] *Id.*, at 16.
[36] *Ibid.*
[37] *Ibid.*

that the application of the financial creditor was filed for a purpose other than for resolution of insolvency as stated in Section 65 of the Code and that the proceedings were malicious.[38]

Applying the reasoning of the Courts in *S.T. Sahib* and *Asset Advisory Services* to determine whether the parameters of 'malicious' as ascribed in these cases can be applied to bring debt recovery applications within the scope of Section 65(1), the conclusion is in the affirmative. It clearly follows that not only do such applications not involve resolution of insolvency, they also, in a broader sense, aim at using the law for a purpose that is not legally appointed or appropriate. The latter deduction is supported by the UN Legislative Guide on Insolvency as cited in *Mobilox,* which says that filing an application just to recover a sum of money would amount to improper use of the insolvency proceedings.

In light of the discussion above, it is submitted that it would be in the best interest of the Code to amend the Section 65 in a manner that clearly outlines malicious intent to entail debt recovery actions. This would help in honouring the real intent and objective of the law and fortify the stand of the IBC in this regard. It could potentially also act as a deterrent for applications that are ill-considered and have a wrongful motive, as the provision prescribes a penalty of one lakh, extending up to one crore, for initiation of proceedings with a malicious intent.

IV. CONCLUSION

When the IBC was enacted in 2016, it was set to be not only a well-intentioned but also the most ambitious piece of economic legislation in the country. In the last three years, since its coming into force, the reviews and records of its operation have been lukewarm at best. The lion's share of the problems pertains to delay in disposing off cases, first at the stage of admission of application and then at the stage of assessing viability, with the 270 day time limit for resolution of insolvency being exceeded in many cases.[39] As per the statistic released by the Insolvency and Bankruptcy Board of India, out of the 1484 cases that were admitted for the CIRP, only 586 were over as on December 2018, indicating that at least 898 cases are still ongoing.[40]

[38] *Ibid.*
[39] Joel Rebello, *With the IBC About to be 3, a Look At the Hits and Misses and the Road Ahead,* ECONOMIC TIMES (April. 24, 2019), https://economictimes.indiatimes.com/industry/banking/finance/banking/changes-challenges-and-interpretation-of-bankruptcy-slaw/articleshow/69017429.cms?from=mdr.
[40] *Ibid.*

In such a situation where the IBC lacks appropriate judicial infrastructure, vexatious and frivolous applications in the form of debt recovery actions will slow down the development further. In examining such applications even at the juncture of admission, attention that is due to genuine parties who are attempting to resolve insolvency and keep the debtor as a going concern may get compromised.

Section 65(1) of the IBC has already taken a step in this direction by penalising malicious initiation of proceedings. All that needs to be done now is to expand the contours of 'malicious' and include debt recovery applications within its ambit. If not done, applications of such a nature will aid in catalysing the process of IBC, meeting the same fate as DRT and SARFAESI, with stakeholders losing their faith in its functioning. On the other side of the coin, if the issue is not promptly addressed, adjudicatory mechanism under these two Acts may end up being rendered infructuous. To ensure legitimacy of the applications that are filed for the NCLT's consideration, an amendment in the law should necessarily be introduced so that the gap within the IBC ecosystem, as highlighted in the course of this note, does not continue to be exploited in the absence of any explicit provision.