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Case Comment: Critical analysis of committee of Creditors of Essar Steel India Ltd. vs Satish Kumar Gupta & Ors.

Aakash Thiagarjamurthy[a] Sheetal Kumar[b]

[a]OP Jindal Global University, Sonipat, India [b]OP Jindal Global University, Sonipat, India

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INTRODUCTION

The final verdict for the case of **Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta & Ors** [1] was delivered by the Supreme court of India in November 2019 with regard to Essar Steel India Limited being acquired under the Insolvency and Bankruptcy Code, 2016. The Code had been newly introduced and there were still many lingering questions that were unanswered about the applicability of the IBC 2016. The proceedings of this case lasted for almost 2 years and the court laid down a binding precedent through this judgement. Through a deep analysis of this case, one can understand how this judgement plays a poignant role in the development of insolvency law in India.

FACTS

Essar Steel India Limited was one of the biggest manufacturers of steel in India. The total overdue debt amounted to about ₹55000 Crore and was one of the biggest cases that the IBC was

[1] Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta & Ors (2020) 8 SCC 531

dealing with IBC. National Company Law Tribunal (NCLT) branch in Ahmedabad issued an order in 2017 initiating insolvency proceedings against Essar Steel and the said application was filed by the State bank of India and Standard Chartered Bank. **Arcelor Mittal India Private Limited** and **Numetal Ltd** and **Vedanta Limited** submitted **resolution plans**. As the court proceedings progressed, the Supreme court held both Arcelor Mittal and Numetal were ineligible to submit resolution plans as they had not yet paid the Non-Performing Assets (NPA) to their respective creditors, and they had to do so in order to become eligible. The important task of selecting a resolution plan to employ by casting votes fell on the **Committee of Creditors (COC)** of Essar Steel. SC further stated that if no plan was chosen by the COC then Essar Steel will be Liquidated. Arcelor Mittal's resolution plan was selected by Essar Steel COC once Arcelor became eligible by making the payments.

CONTENTS OF ARCELOR MITTAL'S RESOLUTION PLAN

Arcelor Mittal's resolution plan first laid down that the COC had the discretion to decide how the funds could be distributed between secured financial creditors. It had provision for payment of ₹42000 crore upfront and ₹8000 crore equity infusion. It laid down that unsecured financial creditors will receive 4% payment of their claim, operational creditors who have claims of less than 1 crore will be paid in full and operational creditors who have a claim of more than 1 crore will not be paid at all. This plan also mentioned that once the financial creditors were paid their dues, all documents given as security apart from corporate or personal guarantees will be assigned to Arcelor Mittal and those documents that cannot be assigned would be terminated. Finally, once the NCLT approved the resolution plan, all the guarantees which were issued /given prior to the initiation of the plan and if a guarantor has any demand on grounds of subrogation, it will be deemed void. But, the financial creditors will still have the right to hold the promoter group accountable and enforce the corporate or personal guarantees against them. The NCLT only partially approved this plan and stated that the COC has to re-think and change the way that the funds will be distributed so that there is no discrimination and so that the operational creditors who have claims of over ₹1,00,00,000 (1 Crore rupees) and Standard

Chartered which is a financial creditor have a higher recovery[2]. Standard Chartered challenged this order along with other aggrieved operational creditors before the National Company Law Appellate Tribunal (NCLAT)[3].

NCLAT ORDER

The NCLAT passed an interim order which directed the Committee of Creditors of Essar Steel to have another meeting to reach a decision post the NCLT order. The COC of Essar Steel in furtherance of this order constructed a meeting and reached that they would make proportionally distribute the money back to the secured financial creditors apart from Standard chartered, and as a moral obligation, they would make ₹ 1000 crore payment to operational creditors who are owed more than ₹ 1 crore. The reason why the COC did not include Standard Chartered in their plans of distribution of funds was that Essar Steel had simply made a guarantee to Standard Chartered that they would give them the money from an offshore subsidiary's debt and the security for this debt was the shares Essar steel owned of the offshore subsidiary itself (which was lower value than the debt taken) and the control of Essar Steel's project assets would not go to them. Hence the COC decided to pay standard chartered money appropriate to the value for the security Standard Chartered held which was about ₹ 61 crores. Finally, the NCLAT passed an order wherein they approved the resolution plan of Arcelor Mittal. They made sure that the unsecured, secured and operational creditors were given equal importance and this made the recovery of each creditor improve to 60.7 %, allowed operational creditors who had still not received relief from the NCLT or NCLAT to continue their pursuing the case filed against Essar Steel after the insolvency resolution proceedings are over and finally the guarantees given by Essar Steel will come to a close after the debt is cleared[4].

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[2] *Standard Chartered Bank & ors v Essar Steel India Limited* 2019 SCC Online NCLT 750 [27]

[3] Rajat Sethi and Aditi Agarwal, 'Case Note: Judgement of the Supreme Court in the Essar Steel Case' (Mondaq, 2021) <https://www.mondaq.com/india/insolvencybankruptcy/1058270/case-note-judgement-of-the-supreme-court-in-the-essar-steel-case#_ftnref15> accessed 26 June 2021

[4] *Standard Chartered Bank & Ors v Satish Kumar Gupta & Ors* 2019 SCC Online NCLAT 388

FINDINGS BY THE SUPREME COURT

Appeals were made before the supreme court questioning the jurisdiction of NCLT and NCLAT and even questioning the powers of the COC and ultimately challenging the order of the NCLAT. But during the pendency of the appeals in the supreme court, simultaneously the Insolvency and Bankruptcy Code (Amendment) Act 2019 was brought into effect with retrospective application of it. The new IBC amendment act stated that the minimum payment that must be given to operational creditors must be larger than the amount to be paid in case of liquidation and the amount to be paid if the amount for resolution is decided in accordance with Section 53 of the IBC[5]. It also enumerated that A Financial creditor who expresses dissent should be given at least a small amount of the sum amount he is to receive in case liquidation happens. It also stated that the COC can validate a resolution plan submitted after it deliberates on the way the funds will be distributed based on the priority of creditors given under **Section 53(1)**[6] and that a distribution of funds in accordance with the new **Section 30(2)(b) of IBC**[7] will be Equitable and Fair. One of the most important changes that were brought in by the amendment was, it became mandatory that all insolvency proceedings had to finish within 330 days from the date at which insolvency proceedings begin and leeway of 90 days is given for those proceedings that had already begun or were subject to litigation[8].

DEVELOPMENTS FROM THIS CASE

In 2019 the supreme court passed the judgement in this case and set precedent on many issues. The **first one** being that **Indian Insolvency law favours a market and creditor process**. The CIRP, Corporate Insolvency Resolution Process is flexible where resolution applicants can give solutions for corporate debtors revival. The Supreme court stated clearly that the COC was the head of the resolution process but couldn't ignore the fact that financial creditors were well versed with the practicability of the company and the feasibility of a resolution plan for the

[5] Insolvency and Bankruptcy Code Amendment Act 2019, s 53
[6] Insolvency and Bankruptcy Code Amendment Act 2019, s 53(1)
[7] Insolvency and Bankruptcy Code Amendment Act 2019, s 30(2)(b)
[8] Nandani Anand, 'Essar Steel Case: How Supreme Court Revised the Revolutionary IBC Regime' (SSRN 2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3643327> accessed 28 June 2021

debtor and that the financial creditors have done adequate due diligence before they granted a loan to the debtor. Supreme court stated that the authority adjudicating must ensure that the COC while making the decision must follow these factors, (i) Corporate debtor will be a going concern while resolution process is going on, (ii) Corporate debtors asset value must be maximised, (iii) all the stakeholders' interests should be balanced. And if these factors have not been considered then the plan will be sent back to the COC and this was reiterated in the case of **Karad Urban Co-operative Bank Ltd. v Swapnil Bhingardevay and Ors[9].** where the court stated that if the above factors have not been complied with, and the COC has approved the plan, then the adjudicating authority will switch to hands-off mode. So the problem that will arise is how a party that wants to dispute the verdict of the COC can produce evidence? Supreme court stated that the resolution applicants are entitled to the full information about the corporate debtor and allowed the COC to form sub-committees to perform minor administrative tasks but stated that the main decision and approval has to come from the COC as most of the important decisions both corporate and managerial are taken by the COC. The supreme court while keeping in mind the importance and power of creditors to decide the viability of the resolution plan and the method of allocation of funds, recognized that the COC does not have a fiduciary duty in particular to a group of creditors but the OC must take business decisions with a majority which includes and binds upon all stakeholders.

The **second major issue** the court resolved was the **equitable treatment of the creditors**. The Supreme court said that it cannot be the case that irrespective of the class or security interest, all creditors are getting the same recovery compensation from the resolution plan. The court held that even in the same group of secured financial creditors, each creditor can be treated differently. The court stated that if the creditor's security interest is not stressed upon and not given importance, then the creditors are more likely to vote for liquidation of the debtor instead of resolution and this goes against the main reason IBC was enacted. If any bankruptcy law weakens, delays, or does not prioritise the security, it makes the reason why the security was made redundant. The supreme court laid down that it is impossible for operational creditors

[9] Karad Urban Co-operative Bank ltd v Swapnil Bhingardevay & Ors AIR 2020 SC 4381 [14]

and financial creditors to be clubbed together and the IBC itself considers operational creditors to be a separate class. But the IBC enumerates some safeguards like a priority in repayment to make sure that the operational creditors' rights are dealt with fairly and equitably. Hence the supreme court stated that the COC can give the green light for resolution plans which give differential payments to operational and financial creditors as long as they are in compliance with the IBC. The supreme court, keeping in mind the powers of the COC to decide the distribution of funds among the classes of creditors, stated that the financial creditors must safeguard the interests of the operational creditors. However, there can arise conflicts of interest as lenders' primary concern is recovery for themselves. And the above checks laid down by the supreme court might not be enough to eradicate the conflict of interest

The third issue the court dealt with was to make certain that the applicants of the resolution were provided with a clean slate to start afresh. The supreme court deemed it imperative that the applicants be well aware of the debts and liabilities of the corporate debtor prior to acquiring it, and must have the opportunity to start on a fresh slate. They likewise specified that the provision in Arcelor Mittal's resolution plan which stated that there will not be a right to subrogation for any of the amounts paid by the promoter group under the guarantees given for Essar Steel was valid. Ultimately the guarantor's claim of subrogation was rendered innocuous. The supreme court relied on the judgement of **State Bank of India v Ramakrishnan**[10]; wherein it was considered that personal guarantors would be out of the purview of moratorium under Section 14 of IBC[11]. Instead, they relied on Section 31 of IBC[12] which opined that Section 31 binds the guarantors of the corporate debtors as well, so payments can be made to the guarantors. The Apex court also held that the moment a resolution plan has been accepted then all the undecided claims of the corporate debtor would be redundant. The introduction of **Section 32A of IBC**[13] provides that prior liability for criminal offences is extinguished. This section gives immunity to the new management of the corporate debtor for crimes committed by the former management.

[10] State Bank of India v Ramakrishnan (2018) 17 SCC 394
[11] Insolvency and Bankruptcy Code 2016, s 14
[12] Insolvency and Bankruptcy Code 2016, s 31
[13] Insolvency and Bankruptcy Code Amendment Act 2019, s 32A

In the case of **Manish Kumar v UOI,** [14] the court understood the importance of new management and that they needed to have a fresh start and rejected the claim that this section was unconstitutional. Successful resolution applicants must start on a fresh slate and should not be subject to pending claims from guarantors.

The **fourth major issue** that the court dealt with is the **requirement of a more expedient process for insolvency resolution**. The supreme court recognised that the **Recovery of Debts Act 1993**, **Sick Industrial Companies (special provisions) Act 1985,** and the **Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002** was a failure as the legal proceedings under these acts were very time consuming and dragged for many years hence to make sure that value of the assets is realised to the maximum extent the court deemed it wrong to eliminate **Section 4** of the IBC Amendment Act[15] which gave a requisite time before which the CIRP had to be finished. The supreme court decided to remove the word 'mandatorily' and hence the CIRP has to be completed in 330 days that is stipulated.

The **fifth issue** is that the **resolution professional cannot perform an adjudicatory function**. The court adjudicated that the resolution professional must only collate, collect and admit claims and he does not need to perform any sort of adjudicatory functions. These claims will finally be decided upon by the COC. All claims need to be sent to the resolution professional to ascertain, a resolution applicant will have knowledge about the amount of money to be paid in order to acquire the business of the corporate debtor. A resolution applicant must not abruptly face 'undecided' claims post acceptance of the resolution plan as this would make amounts payable uncertain.[16] Restricting the resolution professional only to an administrative role and not an adjudicatory role might cause problems as the basis on which creditors' claims are either accepted or rejected is not straightforward and would need an evaluation of the merits of the claim and due to this many operational creditors have filed cases in the NCLAT and NCLT questioning and challenging the treatment of their claims. This problem was highlighted in the

[14] Manish Kumar v UOI 2021 SCC Online SC 30
[15] Insolvency and Bankruptcy Code Amendment Act 2019, s 4
[16] 'Committee Of Creditors of Essar Steel India Limited v Satish Kumar Gupta & Ors. - AAA Insolvency' (Insolvency Professionals, 2019) <https://insolvencyandbankruptcy.in/committee-of-creditors-of-essar-steel-india-limited-vs-satish-kumar-gupta-ors/> accessed 26 June 2021

case of **Swiss Ribbons Pvt. Ltd. v UOI**[17] the court acknowledged the fact that the resolution professional performs only administrative tasks, the liquidator's deduction under section 41 of IBC[18] is something quasi-judicial in nature and there isn't any major difference in the qualification criteria between a resolution professional and a liquidator.

Another important point which the supreme court adjudicated upon was the validity of a sub-committee by the COC. It was held that the COC cannot delegate its powers to anyone else which have important impacts on the functioning of the corporate debtor's business operations. With regard to using section 30(4)[19] to approve a resolution plan, this power is not allowed to be delegated to anyone else as this power has solely been vested with the COC to make important business decisions on its own. The court stated subcommittees can be appointed in order to negotiate or perform ministerial and administrative actions[20].

IMPACT OF THE JUDGEMENT

The potential impact that the judgement will have comes in a few forms where (i) the banks would recover about ₹42000 crores against admitted debts of about ₹49473 crore which is an 85% recovery compared to 53% which is the average recovery in resolution cases. (ii) This judgement would speed up the duration of the resolution process and reduce the dispute between legal and financial creditors. (iii) This judgement will attract investors who were getting apprehensive about the bankruptcy process in the country. Finally, the removal of the mandatory 330-day time limit supports the process of resolution and encourages insolvent companies to go through the process rather than liquidation taking place. This is the main goal of the IBC[21].

[17] Swiss Ribbons Pvt Ltd v Union of India AIR 2019 SC 739
[18] Insolvency and Bankruptcy Code 2016, s 41
[19] Insolvency and Bankruptcy Code 2016, s 30(4)
[20] Pallavi Saluja, 'Essar Steel Judgment: Key Highlights' (Bar and Bench - Indian Legal news, 2021) <https://www.barandbench.com/columns/essar-steel-judgment-key-highlights>accessed 26 June 2021
[21] 'Essar Insolvency Case' (Drishti IAS, 2019) <https://www.drishtiias.com/daily-updates/daily-news-analysis/essar-insolvency-case>accessed 26 June 2021

CONCLUSION

Overall, in this case, the court had to adjudicate on some extremely important aspects of insolvency law and set precedent for future cases which may occur. The supreme court stressed the importance and authority of financial creditors in decisions about the corporate debtor's assets, liabilities, and business and distribution of funds within the creditors and clarified the very few instances that the court can intervene. By applying the 'equality among equals' doctrine, The Supreme court made clear the difference between operational and financial creditors and secured and unsecured creditors. It is clear that if the supreme court had not made changes to the NCLAT order and that if the NCLAT order had been upheld then there would have been major repercussions that the Indian banking sector would have faced where more stressed assets would have been liquidated instead of being sent for resolution by CIRP. The decision was undertaken by the supreme court to extinguish all past claims including the undecided ones provides relief to the resolution applicants who might have been unwilling to invest in companies that have gone insolvent under the IBC due to the possibility of unknown, uncertain, and long-drawn-out litigations. The supreme court by stressing the importance of the need for resolution within 330 days has addressed issues in the previous regulations that caused many problems. This judgement has provided an efficient way of resolution through CIRP under the IBC.