

# Insolvency and Bankruptcy Hotline

January 16, 2018

## SUPREME COURT REMOVES PROCEDURAL HURDLES UNDER BANKRUPTCY CODE FOR FOREIGN OPERATIONAL CREDITORS

- The requirement for an operational creditor to provide a certificate from a financial institution under S. 9(3)(c) of the Code is only directory and not mandatory;
- A demand notice for unpaid operational debt can be sent by a lawyer on behalf of an operational creditor;
- A court must endeavor to interpret the Code to further its objectives without creating a serious general inconvenience to innocent parties; to that end, creative interpretation is also permitted;

### INTRODUCTION

The Supreme Court recently interpreted certain sections of the Insolvency and Bankruptcy Code, 2016 (“Code”) in a favorable manner for foreign operational creditors in its judgment in *Macquarie Bank Limited v Shilpi Cable Technologies Ltd.*<sup>1</sup>

The Court disposed three appeals with similar factual scenarios. In one illustrative case, Hamera International Private Limited (“**Hamera International**”) had executed an agreement with Macquarie Bank Limited, Singapore (“**Macquarie Bank**”), by which the Macquarie Bank purchased the original supplier’s right, title and interest in a supply agreement. Certain amounts became due from the Respondent, Shilpi Cable Technologies Ltd. (“**Shilpi Cable**”) to Macquarie Bank, which gave rise to the present dispute.

Macquarie Bank issued a demand notice through their Advocates under Section 8 of the Code, following which it initiated Corporate Insolvency Resolution Process (“**CIRP**”) by filing a petition under Section 9 of the Code.

### NCLT & NCLAT RULING

The NCLT held that the application ought to be rejected as *first*, Section 9(3)(c) of the Code was not complied with, as Macquarie Bank had failed to submit a certificate from a financial institution as required by the provision; and *second*, that the existence of the debt was disputed by Shilpi Cable in its reply to an earlier statutory notice sent by Macquarie Bank under Sections 433 and 434 of the Companies Act, 1956, making the application liable to be rejected under Section 9(5)(ii) of the Code.

Upholding the ruling of the NCLT, the NCLAT dismissed the appeal. It was held that:

- In its earlier judgment of *Smart timing Steel Ltd v National Steel and Agro Industries Ltd.*<sup>2</sup> it has been held that S. 9 (3) (c) of the Code is mandatory and not directory in nature. This order ought to be followed;
- The notice under S (8)(1) was not issued by Macquarie Bank but by their lawyers. For a notice under this section to be valid, only an “operational creditor himself, or through a person authorized to act on behalf of the operational creditor” can send such notice. Accordingly, an advocate/lawyer cannot issue a notice under Section 8 in absence of any authority as such notice would then be treated as a lawyer’s notice or a pleader’s notice.

### ISSUES BEFORE THE SUPREME COURT (“COURT”)

- Whether S. 9 (3) (c)<sup>3</sup> of the Code is mandatory or directory in nature, especially in context of foreign operational creditors.
- Whether a demand notice of an unpaid operational debt under S. 8(1) can be issued by a lawyer on behalf of an operational creditor.

### CONTENTIONS

#### Macquarie Bank’s Contentions

- Macquarie Bank argued that on a conjoint reading of Section 9(3)(c), Rule 6 and Form 5 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (“**Adjudicating Authority Rules**”), it is clear that Section 9(3)(c) is not mandatory, but only directory and that, in the said section, “*shall*” should be read as “*may*”.
- As per ordinary rules of interpretation of statutes any interpretation according to which a serious general inconvenience is caused to innocent persons or the general public without really furthering the particular object of the act, should not be read as mandatory.
- S.9(3)(c) is a procedural section, which is not a condition precedent to allowing an application under S.9(1).
- If a copy of the certificate can only be from a “financial institution” as defined under S.3(14) of the Code, and if a non-resident bank such as Macquarie Bank is not included under S. 3(14), then it should not operate to non-suit Macquarie Bank. The definition in Section 3(14), though exhaustive, is subject to contextual interpretation,

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therefore, it is clear that a financial institution would include a bank outside the categories mentioned in Section 3(14) when it comes to an operational creditor who is a resident outside India.

### Shilpi Cable's Contentions

- Shilpi Cable argued that the Code being a draconian legislation must be interpreted strictly. On a holistic reading of the Code, it is evident that there is a very low threshold for the rejection of an application for operational creditors (i.e., a pre-existing dispute between the parties).
- The ordinary language of the Section clarifies that a person who may be a resident outside India and who has banking facilities with entities that are not contained within the definition of Section 3(14) would fall outside the Code.
- A lawyer's notice cannot be given under Section 8, read with the Adjudicating Authority Rules and Form 5 therein, as only an "insider" can send such a notice.

### JUDGMENT

The Court set aside the orders of the NCLT and the NCLAT, and held that the Application ought not to be rejected for the following reasons.

#### Nature of S. 9(3)(c)

##### ***A Certificate by a Financial Institution is merely a confirmatory evidence***

It was held that the expression "*confirming*" appearing in Section 9(3)(c) of the Code, makes it clear that although the certificate is a very important piece of evidence, it only *confirms* that there is no payment of an unpaid operational debt. Even Form 5 under Rule 6 of the Adjudicating Authority Rules clarifies that item 7 of Part V is only one of the documents to be submitted as evidence of default. Further, annexure III in the Form also speaks of copies of relevant accounts kept by banks/financial institutions maintaining accounts of the operational creditor, confirming that there is no payment of the unpaid operational debt, only "*if available*". Therefore, a certificate under S. 9 is not a pre-condition to trigger the Code. The true construction of Section 9(3)(c) is that it is a procedural provision, which is directory in nature, as the Adjudicatory Authority Rules read with the Code clearly demonstrate.

##### ***The Code cannot be made discriminatory***

A foreign supplier may have a foreign banker who does not fall within Section 3(14) of the Code. The fact that such foreign supplier is an operational creditor is established from a reading of the definition of "*person*" contained in section 3(23) of the Code, as including persons resident outside India, together with the definition of "*operational creditor*" contained in Section 5(20), which in turn is defined as "*a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred*".

That such person may be banking with an institution which falls outside the scope of Section 3(14) of the Code cannot be construed in a discriminatory fashion so as to include only those foreign operational creditors who happen to bank with financial institutions which are included under Section 3(14) of the Code. Such a discriminatory interpretation would be violative of the right to equality enshrined in Article 14 of the Constitution of India, which applies to all persons including foreigners.

##### ***Purposive Interpretation***

The Court chose to use creative interpretation in coming to the conclusion that the word "shall" in Section 9(3)(c) cannot be interpreted as mandating the provision of a certificate by a financial institution for an application to be complete. It was observed that compliance with the section would be impossible in cases like the present, and that a strict interpretation would cause a serious general inconvenience without furthering the object of the Code. The Court also analyzed various judgments to conclude that even legislations containing drastic measures are being "*creatively interpreted*" by courts.

The Court therefore held that a fair construction of Section 9(3)(c), in consonance with the object sought to be achieved by the Code, would lead to the conclusion that certification by a Financial Institution cannot be construed as a threshold bar or a condition precedent as has been contended by Shilpi Cable.

##### ***The Taylor Principle***

Shilpi Cable relied upon the principle propounded in Taylor v Taylor, i.e., where a statute states that a particular act is to be done in a particular manner, it must be done in that manner or not at all. With respect to this, the Court opined that when this principle leads to impractical, unworkable and inequitable results, it cannot be applied out of context in situations which are predominately procedural in nature.

### ISSUANCE OF NOTICE BY LAWYERS

Relying on earlier judgments, it was held that the expression "in relation to" is very wide and specifically includes a position which is outside or indirectly related to the operational creditor. It was also observed that the expression "practice" under S. 30 of the Advocates Act has a very wide import and this would include all preparatory steps leading to the filing of an application before the Tribunal. Therefore, by reading Section 30 of the Advocates Act and Sections 8 and 9 of the Code together with the Adjudicatory Authority Rules and Forms thereunder harmoniously, the Court concluded that a notice sent on behalf of an operational creditor by a lawyer would be valid, proper and "*in order*".

### ANALYSIS

The Supreme Court, while continuing with its positive approach towards the Code, has interpreted its provisions in a manner so as to make it more inclusive, accessible and far reaching. This judgment of the Supreme Court is another step forward in increasing the accessibility and effectiveness of the Code.

By clarifying the scope of S.9, the Court has removed an important procedural hurdle being faced by several operational creditors not associated with "financial institutions" as defined under the Code. Most foreign operational creditors would have their banking facilities in foreign banks not registered in India and specifically not within the list of "*financial institutions*" as defined under the Code. To keep all such operational creditors outside the ambit of the Code would be self-deprecating, as one of the objects of the Code was to increase ease of doing business in India

for all stakeholders from all jurisdictions and not just Indian entities. The Supreme Court has effectively allowed foreign operational creditors to expeditiously file an application and possibly recover their unpaid dues without getting hampered by onerous procedural necessities or getting entangled into protracted civil litigation.

Breaking through some needless red-tape, the Court has also clarified that a notice sent by a lawyer on behalf of an operational creditor would be in order.

The objectives of the Code have been furthered by applying principles of creative interpretation and harmonious construction. This decision is undoubtedly another feather in the cap for the Indian judiciary, representing their focus on furthering the ease of doing business in India and not compromising substantive justice in the name of mere procedural and technical requirements.

– [Sanjika Dang](#), [Arjun Gupta](#) & [Sahil Kanuga](#)

You can direct your queries or comments to the authors

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<sup>1</sup> Civil Appeal No.15135 OF 2017

<sup>2</sup> Company Appeal (AT) (Insol) No. 28 of 2017

<sup>3</sup> Section 9 (3) (c) states:

(3) The operational creditor shall, along with the application furnish—

...(C) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor;

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