Supreme Court on the powers of the NCLT to initiate the corporate insolvency process on a financial creditor's application

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A two-judge bench of the Supreme Court has recently re-examined the scope of powers of an adjudicating authority under Section 7(5) of the Insolvency and Bankruptcy Code, 2016 (**IBC**) to initiate the corporate insolvency resolution process (**CIRP**) while deciding on a financial creditor's application, in *M Suresh Kumar Reddy v Canara Bank and Ors.* (**Suresh Kumar Reddy**). The issue under consideration in Suresh Kumar Reddy was whether the National Company Law Tribunal (**NCLT**) possesses the power and jurisdiction to examine concerns extraneous to debt and default while considering a financial creditor's application to initiate the insolvency resolution process.

The issue arose when the Supreme Court was asked to decide an appeal filed by a corporate debtor against an order of the National Company Law Appellate Tribunal (**NCLAT**), where the NCLAT had refused to set aside the CIRP initiated against the said debtor.

The Supreme Court held that when a financial creditor files an application to initiate CIRP, the NCLT only has to satisfy itself with (i) the existence of financial debt; and (ii) its default by a debtor. The court proceeded to state that in cases where the existence of such financial debt and its default by the corporate debtor are established as prescribed under the IBC, the NCLT has hardly any discretion left but to proceed with initiating the CIRP, and accordingly dismissed the corporate debtor's appeal.

The Supreme Court has, in a recent decision, sought to narrow the discretion that may be exercised by National Company Law Tribunals in evaluating a financial creditor's insolvency application. The Supreme Court has held that once such a financial creditor has been able to establish debt and default, the tribunal is left with hardly any discretion but to admit such an application. This update examines the impact of the judgment against the backdrop of the Supreme Court's earlier decision in Vidarbha Industries v Axis Bank Limited.

1 Background

Clarity on the scope of powers of the NCLT in relation to deciding on a financial creditor's application has been awaited since the Supreme Court's decision in *Vidarbha Industries v Axis Bank Limited* (**Vidarbha**) in July 2022. In Vidarbha, the Supreme Court had held that the NCLT possesses sufficient discretion to not admit a financial creditor's application even if the existence of financial debt and its default is proven based on the evidence as required under the IBC.[1]

[1] A review petition filed against Vidarbha was also dismissed by the Supreme Court.

The Vidarbha judgment was a departure from the jurisprudence established by the Supreme Court in its recent decisions in *Innoventive Industries Limited v ICICI Bank* (**Innoventive**), *Swiss Ribbons Private Limited v Union of India* (**Swiss Ribbons**) and *E.S. Krishnamurthy & Ors. v Bharath Hi-Tech Builders Pvt. Ltd.* (**ES Krishnamurthy**). The court, after examining the object and purpose of the IBC, acknowledged that the trigger for initiation of insolvency resolution proceedings had changed since the enactment of the IBC, and was no longer a corporate debtor's inability to pay debts, but the existence of default on its debts beyond the specified threshold of INR 1 crore. As such, the Supreme Court has time and again held that the non-payment of debt was sufficient to initiate the insolvency process under the IBC against a corporate debtor.

By contrast, the court in Vidarbha stated that even if default is established, the NCLT could still exercise the discretion to not admit a financial creditor's application for the initiation of the corporate insolvency resolution process.

Apart from marking a departure from the jurisprudence on the subject, Vidarbha also left certain nuances unclear:

a. the decision did not specify why the facts were distinguishable from the Supreme Court's earlier decisions in Innoventive, Swiss Ribbons and ES Krishnamurthy, to justify the deviation from established precedent;

b. the decision did not prescribe which circumstances entitled NCLTs to exercise their '*discretion*' in disallowing a financial creditor's application;

c. the decision resulted in a legal position counterintuitive to the scheme of the IBC, where financial creditors enjoy a status superior to other creditors and are permitted to initiate CIRP based on disputed debts, as long as the amount exceeds INR 1 crore; and

d. the decision expanded the scope of NCLT's limited jurisdiction, despite the IBC mandating minimal judicial intervention in the CIRP.

Practically too, the Vidarbha decision generated litigation as the judgment was routinely cited by corporate debtors before NCLTs/NCLATs to fend off insolvency initiation claims, even if the default of financial debt was established and acknowledged. In such scenarios, tribunals were often faced with the arduous task of either distinguishing the facts of the case under consideration from Vidarbha or having to justify the reasons for exercising their discretion (granted pursuant to the judgment) in favour of CIRP initiation.

2 Suresh Kumar Reddy: a Missed Opportunity?

In view of the issues being faced by the stakeholders pursuant to the decision in Vidarbha, the Ministry of Corporate Affairs has recently proposed an amendment to Section 7 of the IBC to state that once default is established, it is mandatory for NCLT to admit the application and initiate CIRP, without any discretion. Given this background, the Supreme Court in Suresh Kumar Reddy was presented with an opportunity to clarify the legal position post Vidarbha and to possibly do away with the need for such a statutory amendment in the first place.

While deciding Suresh Kumar Reddy, the Supreme Court has made observations on debt and established default being sufficient to initiate CIRP. However, it has not done away with the element of '*discretion*' that the NCLT has been vested with post the decision in Vidarbha i.e., the discretion to refuse the initiation of CIRP, despite established debt and default. Further, and similar to the approach taken by NCLTs/NCLATs, the bench also chose to distance the facts under consideration from the facts in Vidarbha by stating that Vidarbha was pronounced on the basis of facts peculiar to that case.

An alternative approach the court could have considered would have been to refer the Vidarbha judgment to a larger bench, so that the scope of the NCLT's powers when considering financial creditors' applications would have been determined conclusively.

Separately, the bench in Suresh Kumar Reddy could have clarified that the phraseology embodied in Section 7 of the IBC could be interpreted to mean that the NCLT possesses discretion to only admit or dismiss a financial creditor's application on the grounds mentioned in prior Supreme Court decisions. In this way, the Supreme Court could have harmonised the interpretation expounded in Vidarbha with previously established precedents.

In the absence of such clarity, it is likely that the approach adopted by the Supreme Court will not alleviate the current situation, i.e., the continuing dilemma that tribunals face with the Vidarbha judgment still being cited as good law by corporate debtors in their defence. Given the above, it appears that only a legislative amendment clarifying the scope of Section 7 can now resolve these issues.
