

Has Supreme Court Made ‘Consenting’ Easier Or Tougher In The Insolvency Regime?

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The outcome of the first important case of India’s insolvency regime that was decided by the Supreme Court this week has experts confused. The confusion relates to whether, once an insolvency application has been admitted by the National Company Law Tribunal, the parties have the option to withdraw and settle out-of-court.

The matter started at the Mumbai bench of the NCLT where Nisus Finance filed an insolvency application against Lokhandwala Kataria Constructions. The application was filed on grounds that Lokhandwala Kataria failed to repay its debenture holders as per the terms of the agreement. Convinced with the evidence, the NCLT noted that Lokhandwala Kataria Constructions had defaulted in repaying its debt to the financial creditor i.e Nisus Finance and admitted the insolvency application.

But then, the parties changed their mind.

Lokhandwala Kataria Constructions approached the National Company Law Appellate Tribunal against the NCLT order and argued that since a settlement has been reached and part of the amount that was due has been paid, the insolvency process should not proceed. It argued that the NCLAT can use its inherent powers to allow the withdrawal of the application.

The NCLAT disagreed and held that the Insolvency and Bankruptcy Code permits such a withdrawal only prior to the admission of an application. The bench also concluded that since the inherent powers provided in the NCLAT Rules, 2016 have not been notified, they cannot be used. The inherent powers, under Rule 11 of the NCLAT Rules, allow it to give directions in the interest of justice and to prevent process abuse.

Lokhandwala Kataria Constructions challenged this order before the apex court and won.

Though the Supreme Court agreed with NCLAT's conclusion that inherent powers can't be used, it used its powers under Article 142 of the Constitution to allow the parties to settle. Article 142 gives powers to the apex court to pass orders necessary for doing complete justice.

But the grounds for this decision aren't clear and that has experts confused.

It's not clear what the facts and circumstances were that led the apex court to use its powers under Article 142 to accept the consent terms, Divyanshu Pandey, a partner in the banking and finance team of law firm JSA told BloombergQuint.

I don't expect that the Supreme Court will be using this power very frequently for the insolvency regime. But they have correctly held that NCLAT does not have inherent powers to accept the consent terms once an application has been admitted.

Divyanshu Pandey, Partner, JSA

Fereshte Sethna, a partner specialising in insolvency law disagreed with this view. She pointed out that the denial of powers to NCLAT to accept settlements would require parties to obtain the sanction of the Supreme Court if they seek to settle out-of-court after the admission of an insolvency application by the NCLT. This can prove to be onerous, said Sethna.

Since the Supreme Court did not enter into a detailed examination of the scope of powers of the NCLAT in the course of exercise of appellate remedies from an NCLT order of admission, but restricted its observations on a prima facie basis, relying on powers under Article 142 of the Constitution of India to deliver justice, and which in the facts of the case was achieved through the Supreme Court taking on file the consent terms and putting a quietus to the litigation, the issue will have to await another litigation to be settled.

Fereshte Sethna, Partner, DMD Advocates

The NCLAT powers require urgent determination, since the insolvency proceedings can cause death to a company, she added.

Pandey pointed out that the outcome in this case may prompt more and more parties to explore the option of going to the apex court if they decide to consent once an application has been admitted; especially since the reasons for permitting the settlement are not forthcoming in the order.

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