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Examining Section 11 of the Insolvency and Bankruptcy Code 2016

By Lakshya Gupta, December 30, 2018

With the enactment of the Insolvency and Bankruptcy Code (IBC) in 2016, the government has tried to streamline the insolvency and bankruptcy laws across the nation. Chapter II of the Code gives the procedure for initiating a corporate insolvency resolution process (**CIRP**). Section 6 gives the class of persons eligible to initiate a CIRP against a corporate debtor (**CD**). This includes a financial creditor (**FC**), an operational creditor (**OC**) or the CD itself. Section 11 further elaborates who cannot initiate a CIRP. However, the section purports to serve no other purpose than to create confusion when read along with the rest of the Code.

The mischief rule of statutory interpretation suggests that when several views are possible, the one that leads to an absurd result should be rejected. A literal interpretation of the section would suggest that it bars any company against whom CIRP has been initiated to start similar CIRP proceedings against its own debtors. This interpretation runs into the problem of barring such a CD from recovering its own debts. In M/s. Prowess International Private Limited v. M/s. Jai Balaji Industries Limited (decided on 09.08.2018), the Kolkata Bench of the NCLT observed that the petition filed was not maintainable as per the provisions of section 11 of the Code since the petitioner therein was a CD already undergoing a CIRP. However, this ground was not discussed further in the judgement and the petition was ultimately dismissed under section 9 (and not section 11) of the Code.

If section 11 bars a CD from proceeding against its debtors, then this implies that the IBC refuses to acknowledge loans advanced as “assets” that can be used as repayment. This is especially problematic when the CD is in the service sector and may not have tangible assets that can be sold off in an open market. Section 14 already puts a moratorium on proceedings and chapter II does not envisage dual CIRP once already initiated. This interpretation then renders section 11 redundant. Section 11(b) puts a restriction of 12 months for initiating CIRP against a CD only. No such restriction has been imposed on an OC or FC anywhere. This implies that the company’s new creditors can initiate new CIRP against it after the completion of the previous one. But the company being a CD is unreasonably barred for a year after such completion to initiate CIRP against its CDs. Thus, such an interpretation is antithetic to equality.

Another interpretation would suggest that when such a company initiates CIRP, it does so in its capacity as a creditor (OC or FC) and not as a CD. Hence, the bar under section 11 is not attracted. This would imply that the section has no other purpose than to stop the CD from initiating another CIRP against itself. The Code does not allow proceedings under any situation. This interpretation thus limits the application of section 11 to a great extent and essentially renders it a dead letter. In Forech India Pvt. Ltd. v. Edelweiss Assets Reconstruction Company Ltd., (decided on 23.11.2017), the NCLAT rejected the argument that no petition under section 7 of the Code would be maintainable since the company was already undergoing a winding up proceeding. The company was treated as an FC and not a CD and thus section 11 was held to be inapplicable.

However, this is not binding precedent since the case was discussed by the Delhi NCLT (decided on 21.08.2017) while clubbing together several petitions asking the question whether CIRP can be triggered when a winding up petition before a high court is pending. The tribunal explained that the ratio to be gleaned is that the IBC does not bar initiation of proceedings when winding up or liquidation proceedings under the Companies Act, 2013 (or any other Act) are pending. However, if CIRP has already been initiated, the question of entertaining another petition against the same CD does not arise at all as per the provisions of the Code (whether it be by the CD or a new FC or OC).

Chapter II appoints an interim resolution professional (**IRP**) who is responsible for overseeing the CIRP. He manages the operations of the company as a going concern. The powers of the board of directors are suspended immediately after the commencement of CIRP and the IRP becomes solely responsible for the management of the CD's affairs. Purposively interpreting the section, it can be argued that it is an IRP, and not the CD, who can recover the company's dues. The company would thus not be barred from proceeding its debtors. While this may allow recovery of debts, it in no way clarifies under what situation would the bar under section 11 apply. In Jai Ambe Enterprise v. S.N. Plumbing Private Limited (order dated 06.02.2018), the Mumbai Bench took a similar view in holding that an IRP is vested with the powers to recover dues from a company's debtors. The Court placed reliance on section 25 of the Code to include such debtors within the meaning of "assets" to be preserved and protected by an IRP. The Court also stressed on the fact that in the particular case, the petition is filed in the capacity of an OC and not a CD.

But whether an IRP can actually recover dues under the Code is unclear. For one, the explanation to section 11 includes a "corporate applicant". Section 5(5) defines a corporate applicant and includes any person in charge of managing the operations of the CD or who has control/supervision over its financial affairs. Hence, an IRP is a "corporate applicant" and the bar under section 11 would stop him from proceeding against the company's debtors under section 25(2)(b). Moreover, section 18(f) suggests that debtors of the CD are not included within the definition of "assets" of the company

since the CD does not have "ownership rights" over them. Therefore, an IRP would have no control over such debts under section 25(2)(a).

The Chandigarh Bench of the NCLT (decided on 11.10.2017) attempted to discuss the applicability of section 11 but failed to reach a precise conclusion. All it managed to achieve was establish that the bar under section 11 does not apply when proceedings against the debtors of the CD have been lawfully initiated prior to the initiation of CIRP against it. The IRP can continue to represent the CD under section 25(2)(b). While it was opined that the language of section 11 makes it apparent that the CD mentioned therein is a company against whom CIRP has commenced, a specific situation under which the bar would be attracted was not established. It was also observed that considering section 18(f)(vi), pendency of litigation (against debtor) does not give ownership right to CD and thus would not be an "asset" undertaken by an IRP under section 25(1).

If it is agreed that the section aims to bar a CD from recovering its dues by initiating CIRP against its own corporate debtors, it would create a roadblock for the creditors of a CD in recovering their dues, especially when its non-personal assets and personal assets (apart from debtors) are grossly insufficient for recovery. Though the CD can always recover its dues post the completion of CIRP through civil recovery proceedings, one begs to question why the Code would fail to provide for a similar recourse. After all, the IBC was enacted to be an extensive and integrated law for recovery through maximisation of the assets of the CD.

Alternatively, if debtors are included within the definition of "assets" for the purposes of the Code and a CIRP can be initiated by an IRP on behalf of a company, there exists a possibility of creating a chain of proceedings. Each CD would try to recover its dues by initiating CIRP against its own debtors. Companies often siphon money by transferring money from one company to another in the form of loans and advances, before ultimately utilizing it. It is almost impossible to be able to find this money unless such recovery is initiated from a CD's debtors. However, if such overlapping proceedings are triggered, this would be antithetic to the "time-bound" objective of the Code since the process would not be complete until all such dues are recovered. However, trying to get to the end of such a debt chain would engage a CD in unnecessary litigations and would nullify the purpose of section 14 of the Code. If such debts are not recovered, the object of maximisation of value of assets would not be fulfilled.

Section 11 plainly seems to bar a CD from initiating CIRP. But as discussed above, the practical application of such a bar runs into several problems. Generally, the practice so far has been to allow CDs to file petitions under the Code as OCs or FCs, without any deliberation over the impact of section 11. The purpose of the section and exactly who it intends to create a bar against is still unclear.

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