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The NCLT has the discretion to adjourn/reject application under Section 7(5)(a) of IBC despite existence of default

Vidarbha Industries Power Limited v. Axis Bank Limited

Citation	2022 SCC OnLine SC 841
Date	12 July 2022
Court	Supreme Court of India
Coram	Hon'ble Justice Indira Banerjee Hon'ble Justice JK Maheshwari

1. Factual Matrix & Procedural History:

- 1.1 Vidarbha Industries Power Limited (“**the Appellant**”) is a generating company. The Appellant has set up coal fired thermal power plants in Maharashtra. Through a competitive bidding process held by Maharashtra Industrial Development Corporation (“**MIDC**”), the Appellant was awarded contract for Group Power Project (“**GPP**”) which was later converted to Independent Power Project (“**IPP**”).
- 1.2 Thereafter, Maharashtra Electricity Regulatory Commission (“**MERC**”) approved a power procurement agreement between the appellant and Reliance Industries Limited (“**RIL**”).
- 1.3 Under this arrangement, RIL was granted permission by MERC for procuring power from the appellant. A power purchase agreement was executed between the appellant and RIL for power generated from appellant’s power plant. In 2015 MERC approved the final tariff of the power plant of the appellant for the financial years 2014-2015 and 2015-2016.
- 1.4 In 2016, the appellant made an application to the MERC for the purpose of trying up the aggregate revenue requirement and for determination of tariff, due to the rise in the cost of procuring coal for the purpose of running the power plant. MERC disallowed substantial portion of the actual fuel costs and capped the tariff for the financial years 2016-2017 to 2019-2020. Due to the same, the appellant filed an appeal to Appellate Tribunal for Electricity (“**APTEL**”). APTEL held in favour of the appellant *vide* order dated 3rd Nov 2016 and awarded a sum of Rs.1, 730 Crores to the appellant.
- 1.5 For implementation of the aforesaid order of APTEL, the appellant filed an application before the MERC. However, MERC had filed an appeal before the Supreme Court (“**SC**”) challenging the order of APTEL. As on date, the said appeal is pending.
- 1.6 The appellant contended that in view of the pending appeal, it was short of funds and therefore, unable to clear all its outstanding liabilities.
- 1.7 On 15th Jan 2020, Axis Bank Limited (“**the Respondent**”), a financial creditor of the Appellant, filed an application under section 7 of the Insolvency and Bankruptcy Code, 2016 (“**the Code**”) to initiate Corporate Insolvency Resolution Process (“**CIRP**”) against the appellant, before National Company Law Tribunal Mumbai (“**NCLT**”). The Appellant filed an application seeking stay of the CIRP as long as the appeal was pending in the SC. NCLT dismissed the application filed by appellant on the ground that no extraneous matter should come in the way of expeditiously deciding upon an application made under Section 7 of the Code. Reliance was placed on the judgment of *Swiss Ribbons v Union of India*¹. The dispute between the appellant and the electricity regulator or the recipient of electricity was considered as extraneous to the matters involved in the petition.
- 1.8 The National Company Law Appellate Tribunal (“**NCLAT**”), on appeal, upheld the order of the NCLT. An appeal was preferred against the NCLAT order before the SC.

¹ (2019) 4 SCC 17.

2. Issue:

- 2.1. Whether NCLT can decline to admit applications under Section 7(5)(a) of the IBC despite the existence of default?

3. Contentions on behalf of the Appellant:

- 3.1 The appellant submitted that in view of the special nature of the business of the appellant of production of electricity where the tariff is regulated by MERC and APTEL, the application under Section 7 of the Code should not have been admitted.
- 3.2 The appellant submitted that the word used in Section 7(5) (a) of the Code is 'may', which clearly permits the NCLT to reject an application even when there is existence of debt and default.
- 3.3 The appellant submitted that a conjoint reading of Section 7(5)(a) of the Code with Rule 11 of the National Company Law Tribunal Rules, 2016 further reveals that NCLT has discretion to admit or not admit the application.
- 3.4 The appellant argued the NCLT has the power to defer the hearing of the petition, since there are favourable orders in his favour which would enable it to liquidate its debt.

4. Contentions on behalf of the Respondent:

- 4.1 The respondent submitted that Section 7(5) (a) of the Code casts a mandatory obligation on NCLT to admit the application once it found that a corporate debtor had committed default in repayment of its dues. The respondent relied on Section 7(4) of the Code to state that NCLT is mandatorily required to ascertain existence of the default. If the NCLT does not ascertain the existence of default, it is bound to record its reasons in writing for not doing so. In this regard, reliance was also placed on the judgment in *Swiss Ribbons Private Limited and Anr. v. Union of India and Ors.*²
- 4.2 The Respondent submitted that the Appellant has made several attempts to delay the insolvency proceedings.

5. Judgment:

- 5.1 The Supreme Court held that Section 7(5)(a) of the Code confers discretionary power on the NCLT. The Court also observed that the existence of a financial debt and default in payment thereof only gave the financial creditor the right to apply for initiation of CIRP. Thereafter, NCLT was required to apply its mind to relevant factors such as feasibility of initiation of CIRP, against an electricity generating company operated under statutory control, the impact of MERC's appeal, pending in the Supreme Court, order of APTEL and the overall financial health and viability of the Corporate Debtor under its existing management.
- 5.2 The Court observed that use of the expression 'may' in Section 7(5)(a) of the Code clearly conveys the intent of legislature to confer discretion to admit applications under Section 7 of the Code. In contrast, the Court clarified that the use of the

² *ibid.*

word 'shall' places a mandatory requirement. The Court applied the principles of literal interpretation and relied upon the judgments of *Lalita Kumari v. Government of Uttar Pradesh and Ors*³, *Hiralal Rattanlal v. State of Uttar Pradesh*⁴ and *B. Premanand v. Mohan Koikal*⁵ to come to this conclusion.

- 5.3 The Court compared Section 7(5)(a) with Section 9(5) of the Code. It stated that the legislature had intentionally used the expression 'shall' under Section 9(5), where the NCLT has to take a decision within 14 days to accept or reject the application made by the operational creditor. Accordingly, Section 9(5)(a) of the Code is mandatory and Section 7(5)(a) of the Code is discretionary.
- 5.4 The Court also noted that legislature has consciously differentiated between financial creditors and operational creditors. The provisions in the Code for operational creditor, with undisputed debts, are rigid and inflexible. In the case of financial creditors, there is a little more flexibility. Therefore, NCLT has been conferred with the discretion to admit applications of the financial creditor.
- 5.5 The Court also opined that in case of rejection of an application, the financial creditor is not denuded of the right to apply afresh for initiation of CIRP, if its dues remain unpaid.
- 5.6 The Court also clarified that discretionary power under Section 7(5)(a) of the Code must not be exercised arbitrarily or capriciously. The Court held that NCLT must consider the grounds made out by the corporate debtor against admission, on its own merits.
- 5.7 The court allowed the appeal stating that NCLT and NCLAT fell in grave error in disregarding that a huge sum was realizable by the Appellant in terms of the order passed by APTEL in favour of the Appellant.

6. PSL Opinion:

- 6.1 The Supreme Court in this judgement has correctly analysed S. 7(5)(a) and S. 9(5)(a) of the Code. It would be extensively unfair to the interests of the Corporate Debtor had the arguments of the Respondent been upheld. The Court correctly identified the distinction between operational creditor and financial creditor for the purposes of the Code. Specifically, the Court also correctly applied the literal rule of interpretation in concluding that the NCLT may in certain exceptional circumstances decline applications of financial creditors. However, it remains to be seen on what parameters the NCLT will decline to admit applications and the limitations of NCLT with reference to the same.

³ (2014) 2 SCC 1.

⁴ (1973) 1 SCC 216.

⁵ (2011) 4 SCC 266.