

How Financial Creditors Trigger CIRP under Section 7 IBC: Do They Need a Demand Notice?

THE INSOLVENCY AND BANKRUPTCY CODE, 2016 ("IBC") MARKS A PARADIGM SHIFT IN INDIA'S INSOLVENCY REGIME. ONE OF ITS KEY FEATURES IS THE INITIATION OF THE CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP) BY FINANCIAL CREDITORS UNDER SECTION 7 OF THE CODE. UNLIKE SECTION 8, WHICH REQUIRES THE ISSUANCE OF A DEMAND NOTICE BY AN OPERATIONAL CREDITOR, SECTION 7 DOES NOT EXPLICITLY MANDATE THE ISSUANCE OF A DEMAND NOTICE BEFORE INITIATING PROCEEDINGS. HOWEVER, THE PROCESS UNDER SECTION 7 DOES REQUIRE COMPLIANCE WITH CERTAIN PROCEDURAL REQUIREMENTS THAT FUNCTIONALLY MIRROR THE DEMAND NOTICE REQUIREMENT. THIS ARTICLE SEEKS TO EXPLORE THE LEGAL POSITION, PRACTICAL IMPLICATIONS, AND JUDICIAL PRONOUNCEMENTS RELATED TO DEMAND NOTICE AND INITIATION OF INSOLVENCY PROCEEDINGS UNDER SECTION 7 OF THE IBC.

I. Legal Framework: Section 7 of the IBC

- ▶ Section 7 of the IBC provides that a financial creditor, either by itself or jointly with other financial creditors, may file an application for initiating CIRP against a corporate debtor when a default has occurred. The key components of Section 7 include:
- ▶ Who can apply: Financial creditors, individually or jointly.
- ▶ Trigger: Occurrence of default.
- ▶ Adjudicating Authority: National Company Law Tribunal (NCLT).
- ▶ Timeframe: The NCLT is required to ascertain the existence of default within 14 days of receiving the application.
- ▶ Unlike operational creditors under Section 8 who must serve a demand notice in Form 3 or 4, financial creditors are not required to send such a notice. Instead, they are required to file the application in Form 1 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

II. Concept of Demand Notice and Its Inapplicability under Section 7

- ▶ Demand notice under Section 8(2) of the IBC serves as a pre-litigation mechanism providing the corporate debtor an opportunity to repay the outstanding dues or raise a dispute. The absence of a similar requirement under Section 7 has raised several questions about natural justice, fairness, and opportunity to cure the default.
- ▶ The Supreme Court, in *Innoventive Industries Ltd. v. ICICI Bank* (2018) 1 SCC 407, clarified that financial creditors need only show that a default has occurred. Once the Adjudicating Authority is satisfied, the CIRP is initiated.
- ▶ The rationale for not mandating a demand notice for financial creditors is rooted in the nature of financial debt, which typically arises from structured lending mechanisms and banking transactions that provide the debtor with prior knowledge of their obligations and defaults. Hence, a separate demand notice is seen as redundant.

III. Procedural Safeguards in Lieu of Demand Notice

- ▶ Even though a formal demand notice is not required under Section 7, certain procedural steps ensure the debtor is not blindsided:
- ▶ Filing of Form 1: The financial creditor must submit documentary evidence of default, including copies of loan agreements, records of default from the Information Utility (e.g., NeSL), or entries in the books of account.
- ▶ Service of Application: The Rules require that a copy of the application filed under Section 7 be served upon the corporate debtor, ensuring that they have notice of the initiation of proceedings.
- ▶ Right to be Heard: Before admitting the application, the Adjudicating Authority gives the corporate debtor an opportunity to contest the claim and show that no default has occurred.
- ▶ These safeguards effectively fulfill the principles of natural justice, even in the absence of a demand notice.

IV. Judicial Precedents

Numerous judicial pronouncements have addressed the issue of whether a demand notice is essential under Section 7:

- ▶ **Innoventive Industries Ltd. v. ICICI Bank:** The Supreme Court held that the moment the Adjudicating Authority is satisfied that a default has occurred, it must admit the application. No requirement of prior notice was deemed necessary.
- ▶ **Swiss Ribbons Pvt. Ltd. v. Union of India (2019) 4 SCC 17:** The Supreme Court emphasized the distinction between operational and financial creditors, affirming the constitutional validity of differing treatment, including the absence of a demand notice under Section 7.
- ▶ **Sree Metaliks Ltd. v. Union of India [Calcutta HC, 2017]:** The Calcutta High Court emphasized that even in the absence of a formal demand notice, the principles of natural justice are preserved by allowing the corporate debtor to be heard before the application is admitted.
- ▶ **Vidarbha Industries Power Ltd. v. Axis Bank Ltd. (2022) 8 SCC 352:** This ruling introduced a nuanced view by holding that the Adjudicating Authority is not bound to admit the application merely upon the existence of default, particularly when extraneous circumstances justify non-payment.

V. Information Utility and Its Role

- ▶ A significant reform introduced by the IBC is the institution of Information Utilities (IUs). These are central repositories of financial information that creditors can rely upon to substantiate claims of default.
- ▶ As per Section 7(3)(a), a financial creditor is required to furnish records of default with the application. A record from an IU is deemed conclusive evidence of default under Rule 4 of the Adjudicating Authority Rules. This obviates the need for additional layers of communication like demand notices, as the debtor is deemed to have access to the records.

VI. Advantages and Criticisms of Omission of Demand Notice

► Advantages:

- Speed and Efficiency: Direct initiation enables faster admission of insolvency cases.
- Financial Discipline: Promotes credit discipline by holding debtors accountable without further grace periods.
- Legal Certainty: The clarity of Section 7 ensures predictability in enforcement mechanisms.

► Criticisms:

- Lack of Pre-admission Cure Opportunity: Debtors do not get a last-minute chance to settle.
- Risk of Misuse: Creditors may use insolvency threats for coercive recoveries.
- Natural Justice Concerns: Some argue it fails to meet the audi alteram partem rule, though judicial safeguards do exist.

VII. Comparative Perspective

- ▶ In many jurisdictions, pre-insolvency resolution mechanisms include a mandatory notice requirement. For instance:
- ▶ United Kingdom: Creditors must serve a statutory demand and wait for 21 days before initiating winding-up.
- ▶ United States: Chapter 11 of the Bankruptcy Code allows for creditor negotiations before formal proceedings.
- ▶ India's approach under Section 7 is comparatively creditor-friendly but not out of sync with international standards when viewed in light of the safeguards provided.

VIII. Best Practices for Financial Creditors

- ▶ Financial creditors should adopt the following practices when initiating action under Section 7:
 1. Ensure IU Registration: File records of the loan and default with an Information Utility.
 2. Proper Documentation: Maintain loan agreements, sanction letters, and bank statements.
 3. Compliance with Form 1 Requirements: Ensure the application is complete in all respects.
 4. Voluntary Intimation(optional): Though not mandatory, sending a pre-filing intimation may help preserve the commercial relationship.

X. Conclusion

- ▶ Section 7 of the IBC reflects the legislative intent to empower financial creditors with swift remedial mechanisms against defaulting corporate debtors. The absence of a formal demand notice is balanced by procedural safeguards like filing requirements, service of application, and opportunity of hearing before admission. While concerns around natural justice and coercive use remain, Indian courts have adequately addressed them through an evolving jurisprudence that emphasizes fairness, transparency, and accountability.
- ▶ As the IBC matures, the role of information utilities, creditor committees, and judicial oversight continues to evolve, ensuring that the framework remains robust and responsive. Financial creditors, while enjoying significant powers under Section 7, must use the provision judiciously, keeping in mind not only the legal thresholds but also the broader commercial implications.

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