

# LAW & POLICY UPDATE

## RESTRUCTURING & INSOLVENCY



## Termination of Power Purchase Agreements under IBC

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The Supreme Court (SC) vide judgment dated March 08, 2021 in the matter of *Gujarat Urja Vikas Nigam Ltd v. Amit Gupta & Ors*<sup>1</sup>, upheld the order passed by the National Company Law Appellate Tribunal (NCLAT) and the National Company Law Tribunal, New Delhi Bench (NCLT) setting aside the termination of the Power Purchase Agreement (PPA) by the Gujarat Urja Vikas Nigam Ltd (GUVNL/Appellant) and observed that 'In this case, the PPA has been terminated solely on the ground of insolvency, which gives the NCLT jurisdiction under Section 60(5)(c) to adjudicate this matter and invalidate the termination of the PPA as it is the forum vested with the responsibility of ensuring the continuation of the insolvency resolution process, which requires preservation of the Corporate Debtor as a going concern.'

### Background Facts

- On April 30, 2010, GUVNL and Astonfield Solar (Gujarat) Pvt Ltd (**Corporate Debtor**) executed a PPA basis which GUVNL agreed to purchase all the power generated by the Corporate Debtor through its Solar Power Plant.
- Due to the heavy rainfall and the flood in Gujarat during June and July 2017, the Solar Power Plant of the Corporate Debtor was severely damaged, and the Corporate Debtor was only able to operate at 10 – 15% of its original capacity. Hence, the Corporate Debtor suffered major financial crunch. Consequently, the Corporate Debtor was unable to fully service its debt to the Financing Parties and the Corporate Debtor was declared to be a Non-Performing Asset (NPA) on May 04, 2018.
- Thereafter, vide Order dated November 20, 2018, the NCLT admitted a petition filed by the Corporate Debtor under Section 10 of the Insolvency and Bankruptcy Code, 2016 (IBC) and directed for commencement of Corporate Insolvency Resolution Process (CIRP) in respect of the Corporate Debtor. Mr. Amit Gupta was appointed as the Insolvency Resolution Professional of the Corporate Debtor (**Respondent No. 1**). Thereafter, vide order dated February 01, 2019, the Respondent No. 1 was confirmed as the Resolution Professional of the Corporate Debtor by the NCLT.
- However, on May 01, 2019, GUVNL issued two notices of default to the Corporate Debtor (in terms of Clause 9.2.1(e)2 and 9.2.1(a) of the PPA) and thereafter, on May 21, 2019, GUVNL affirmed to the Corporate Debtor that they would be terminating the PPA with the Corporate Debtor on the ground that the Corporate Debtor is undergoing insolvency.

### Our viewpoint

It is a well understood fact that a PPA is *sine quo non* for not only the functioning but the very existence of a Power Project. This judgment in as much as it ensures the continuity of the PPAs, would bring a sigh of relief to the lenders of the power generators which are undergoing insolvency proceedings as it would help in value maximization. Moreover, provided that the Corporate Debtor is able to fulfil the supply obligations, this decision would ensure that the Corporate Debtor would have a steady source of income and would continue to function as a going concern during the resolution process.

<sup>1</sup> Civil Appeal No. 9241 of 2019

<sup>2</sup> Clause 9.2.1(e): If the Power Producer becomes voluntarily or involuntarily the subject of proceeding under any bankruptcy or insolvency laws or goes into liquidation or dissolution or has a receiver appointed over it or liquidator is appointed, pursuant to law, except where such dissolution of the Power producer is for the purpose of a merger, consolidated or reorganization and where the resulting entity has the financial standing to perform its obligations under the Agreement and credit worthiness similar to the Power producer and expressly assumes of obligations under the agreement and is in a position to perform them.

- Thereafter, the Respondent Nos. 1 & 2 (the Resolution Professional and EXIM Bank) preferred Applications before the NCLT under Section 60(5) of IBC seeking an injunction restraining GUVNL from terminating the PPA with Corporate Debtor. This Application was allowed by NCLT vide order dated August 29, 2019 whereby GUVNL was restrained from terminating the PPA. The NCLT also set aside the notice of default dated May 01, 2019. It is pertinent to note that the NCLT's reasoning in its final order for restraining GUVNL from terminating the PPA was premised on the fact that PPA was an 'instrument' within meaning of Section 238 of IBC and therefore, the clauses of the PPA cannot be placed on a higher pedestal than provisions of IBC. Thus, NCLT held that the clauses of PPA (with regard to Termination on account of insolvency) are inconsistent with the provisions of the IBC and stand overridden in terms of Section 238 of the IBC.
- Aggrieved by the abovementioned, GUVNL filed an Appeal before the NCLAT, which was dismissed by the Appellate Tribunal vide order dated October 15, 2019 (**Impugned Order**). The NCLAT noted that the Corporate Debtor was to be maintained as a going concern in accordance with the objects of the IBC and termination of the PPA would render the Corporate Debtor defunct. Thus, GUVNL could not terminate the PPA solely on the ground of the initiation of CIRP of the Corporate Debtor.
- In the above background, GUVNL approached the SC.

### Issues at hand

- Whether the NCLT/NCLAT can exercise jurisdiction under the IBC over disputes arising from contracts such as the PPA?
- Whether GUVNL's right to terminate PPA in terms of Article 9.2.1(e) read with 9.3.1 of the PPA is regulated by the IBC?

### Findings of the court

- Pursuant to the arguments made by the parties, SC observed as under:

#### Issue 1: Jurisdiction of NCLT/NCLAT under the IBC over disputes arising from contracts such as the PPA

##### **Jurisdiction of the NCLT/NCLAT over contractual disputes**

- In order to enumerate the contours of the jurisdiction which can be exercised under Section 60(5)(c) of the IBC, SC emphasised upon understanding the extent of the words 'arising out of' and 'in relation to' as used under Section 60(5)(c) of the IBC.
- The Court referred to the principles of statutory interpretation and observed that while the phrases 'arising out of' and 'relating to' have been given an expansive interpretation in various cases, words can have different meanings depending on context. The Court also reiterate that the words of a statute have to be construed in a manner which would give them a sensible meaning which accords with the overall scheme of the statute.
- In view of the above, SC was of the opinion that while construing Section 60(5), a starting point for the analysis

must be to decipher Parliamentary intent based on object underlying the enactment of the IBC.

- Thereafter, the Apex Court shed light upon the intent behind the introduction of the IBC and the essence for its working i.e. ensuring continuity of 'going concern' status, to avoid multiplicity of legislation and adjudicating bodies dealing with issues pertaining to insolvency and bankruptcy, and to ensure a timely resolution of the Corporate Debtor.
  - In view of the same, SC referred to the observations made in the Report of the BLRC, and also reiterated the ratio in various cases such as *Innovative Industries*<sup>3</sup> and *Arcelor Mittal (India) (Pvt) Ltd*<sup>4</sup>, whereafter it was concluded that considering Section 60(5)(c) and the interpretation of similar provisions in other insolvency related statutes, the NCLT has jurisdiction to adjudicate disputes, which arise 'solely' from or which relate to the insolvency of the Corporate Debtor. However, in doing so, NCLT and NCLAT must ensure that they do not usurp the legitimate jurisdiction of other Courts, Tribunals and fora when the dispute is one which does not arise solely from or relate to the insolvency of the Corporate Debtor. Thus, Resolution Professional can approach NCLT for adjudication of disputes which are related to CIRP.
  - However, for adjudication of disputes that arise de hors insolvency of Corporate Debtor, Resolution Professional must approach the relevant competent authority.
  - Lastly, regarding the facts of the current case, SC observed that as the dispute had arisen solely on the ground of the insolvency of the Corporate Debtor, therefore, the NCLT was empowered to adjudicate this dispute under Section 60(5)(c) of the IBC.
- **Jurisdiction of NCLT and the State Commission (GERC) regarding the application of the clauses of the PPA**
- The arguments advanced by the counsels of the parties premised around determining the nature of the PPA as an 'instrument' under the provisions of IBC, particularly application of the non - obstante clause in Section 238 of IBC which has an overriding effect over the clauses of PPA which have the force of law under the Electricity Act, 2003.
  - SC deliberated and differentiated the facts of the present case with ratio laid down in the matter of *Embassy Property Developments Pvt Ltd v. State of Karnataka*<sup>5</sup> and *Municipal Corporation v. Abhilash Lal*<sup>6</sup> and observed that even though the aforementioned cases dealt with the extent of the statutory power of the NCLT to adjudicate upon matters of public law, however, the decisions laid down therein cannot be applied to the facts of the present case.
  - While arriving at this conclusion, the reasoning by the court was that the decision to terminate PPA was not taken by any governmental or statutory authority acting within the domain of its public law functions. The decision had simply been taken by a contracting party solely on account of the initiation of insolvency proceedings against Corporate Debtor in terms of an agreement between the parties.

<sup>3</sup> (2018) 1 SCC 407

<sup>4</sup> (2019) 2 SCC 1

<sup>5</sup> (2020) 13 SCC 308

<sup>6</sup> (2020) 13 SCC 234

- Further, the Court also held that Section 238 of the IBC does not state that the instrument must be entered into by operation of law, rather it states that the instrument has effect by virtue of any such law. In other words, the instrument need not be a creation of a statute. It becomes enforceable by virtue of a law.
- Hence, it was concluded that NCLT's jurisdiction could be invoked in present case because termination of PPA was sought solely on ground that Corporate Debtor is subject to an insolvency resolution process under IBC.

#### ▪ **Residuary jurisdiction of the NCLT under Section 60(5)(c) of the IBC**

- SC held that residuary jurisdiction of NCLT under Section 60(5)(c) of IBC provides it with a wide discretion to adjudicate questions of law or fact arising from or in relation to insolvency resolution proceedings. If jurisdiction of NCLT were to be confined to actions prohibited by Section 14 of IBC, there would have been no requirement for legislature to enact Section 60(5)(c) of IBC. Section 60(5)(c) would be rendered otiose if Section 14 is held to be exhaustive of grounds of judicial intervention contemplated under IBC in matters of preserving value of CD and its status as a going concern. However, it is pertinent to mention that NCLT cannot exercise its jurisdiction over matters dehors insolvency proceedings since such matters would fall outside the realm of IBC. Further, NCLT's residuary jurisdiction, though wide, is nonetheless defined by text of IBC.

#### **Issue 2: GUVNL's right to terminate the PPA in terms of Articles 9.2.1(e) read with 9.3.1 is regulated by IBC**

##### ▪ **Validity of ipso facto clauses**

- In order to determine the validity of termination of PPA in terms of Articles 9.2.1(e) read with 9.3.1 of the PPA, which were considered as the ipso facto<sup>7</sup> clauses of the PPA, SC examined the legal position and the applicability of such ipso facto clauses in India, particularly with respect to its application over Section 14 of the IBC.
- The Court took note of the observations made in Report of the Expert Committee on Company Law headed by J.J. Hirani, which observed that there is a need to invalidate ipso facto clauses so as to prevent the value of a Corporate Debtor's assets from becoming diluted during the insolvency process. However, this invalidation was to be subject to exceptions, keeping in mind the compelling, commercial, public or social interest in upholding the contractual rights of the counter party to the contract.
- SC thereafter discussed the Insolvency and Bankruptcy Code (Amendment) Act, 2020 which, inter alia introduced an Explanation to Section 14(1) and the legislative intent for its introduction. The aforesaid Explanation introduced by way of the amendment prohibited the suspension or termination of any license, permit, registration, quota, concession, clearances or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force

on the grounds of insolvency of Corporate Debtor. The legislative intent behind this amendment was to ensure that Corporate Debtor continues to function as a going concern during moratorium period imposed under Section 14 of IBC.

- In view of the above observations read parallelly with the legal precedents and the standards set globally, SC acknowledged that from the bare text of the IBC, no clear position emerges in relation to the validity of ipso facto clauses in other contracts. Owing to the principle of separation of powers, the Court limited itself from setting any general principle of law and held that the question of the validity/invalidity of ipso facto clauses in contracts is one which the Court ought not to resolve exhaustively in the present case. Rather, an appeal can be made to the legislature to provide concrete guidance on this issue, since the lack of a legislative voice on the issue will lead to confusion and reduced commercial clarity.

##### ▪ **Validity of the termination of the PPA**

- It was observed that in the facts of the present case, in case of termination of the PPA, the Corporate Debtor would no longer remain as a going concern. Thus, the continuation of the PPA assumes enormous significance for the successful completion of the CIRP.
- It was noted that the inclusion of the Explanation to Section 14(1) and Section 14(2A) of the IBC indicated that Parliament has been amending the IBC to ensure that the status of a Corporate Debtor as a going concern is not hampered on account of varied situations, which may not have been contemplated at the time of enacting the IBC.
- SC reiterated the observations given by it with respect to ambit of powers of NCLT under Section 60(5)(c) to entertain and dispose of any question of fact or law 'solely' arising out or in relation to the insolvency resolution process and concluded that in the factual matrix of the given case and the significance of PPA (which was terminated solely on the ground of insolvency) for successful resolution of Corporate Debtor, NCLT was empowered to restrain GUVNL from terminating the PPA.
- However, while arriving at this conclusion, SC specifically indicated that in all future cases, NCLT would have to be wary of setting aside valid contractual terminations which would merely dilute the value of the Corporate Debtor, and not push it to its corporate death.

#### **Decision of the Court**

On the basis of the above findings, SC held that:

- The NCLT/NCLAT could have exercised jurisdiction under Section 60(5)(c) of the IBC to stay termination of PPA by GUVNL, since GUVNL sought to terminate PPA only on account of CIRP being initiated against the Corporate Debtor.
- NCLT/NCLAT correctly stayed termination of PPA, since allowing it to terminate PPA would certainly result in corporate death of Corporate Debtor due to PPA being its sole contract.
- SC left open the broader question of validity/invalidity of ipso facto clauses in contracts for legislative intervention.

<sup>7</sup> ipso facto clauses arise in a variety of contracts. Ipso facto clauses are contractual provisions which allow a party (terminating party) to

terminate the contract with its counterparty due to the occurrence of an event of default.



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