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Ineligible Promoter – All Doors Shut:


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The conundrum whether a scheme of compromise and arrangement can be proposed by the erstwhile promoter at liquidation stage, who otherwise is ineligible to participate in the resolution process under the Insolvency and Bankruptcy Code, 2016 (“Code”) has been put to rest by the Insolvency and Bankruptcy Board of India (“IBBI”). The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (“Liquidation Regulations”) was amended by IBBI on 06.01.2020 to clarify that persons not eligible under the Code to submit a resolution plan for insolvency resolution of the corporate debtor, cannot submit any scheme of compromise or arrangement during the liquidation stage¹. This amendment *per se* does not bar every promoter of an ailing company from proposing a scheme but promoters who are otherwise ineligible to submit a resolution plan during the resolution process under the Code.

Passing the Eligibility Test

Section 29A of the Code prescribes the eligibility criteria for a resolution applicant. It is a restrictive provision and any person falling in the negative list is not eligible to submit a resolution plan. In other words, the person submitting the resolution plan should not suffer from any disqualification mentioned under Section 29A of the Code. It is thus imperative to have a look at the disqualifications delineated under Section 29 A of the Code:

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- (i) the person is an un-discharged insolvent;
 - (ii) the person is a willful defaulter in terms of the RBI Guidelines issued under the Banking Regulation Act, 1949;
 - (iii) the person has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with RBI Guidelines issued under the Banking Regulation Act, 1949 and at least a period of 1 (One) year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor: Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to non-performing asset accounts before submission of resolution plan;

¹ *Ins. by Notification No. IBBI/2019-20/GN/REG053, dated 6th January, 2020 (w.e.f. 06-01-2020)*

- (iv) the person has been convicted for any offence punishable with imprisonment for 2 (two) years or more;
- (v) the person is disqualified to act as a director under the Companies Act, 2013;
- (vi) the person is prohibited by SEBI from trading in securities or accessing the securities markets;
- (vii) the person has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and an order has been made by the adjudicating authority under the provisions of the Code;
- (viii) a person who has executed an enforceable guarantee in favour of a creditor, in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under the Code;
- (ix) a person who has been subject to the above listed disabilities under any law in a jurisdiction outside India;
- (x) connected persons, i.e. persons connected to the person disqualified under any of the aforementioned points, such as those who are promoters or in management or control of the resolution applicant, or will be promoters or in management or control of the business of the corporate debtor during the implementation of the resolution plan, the holding company, subsidiary company, associate company or related party of the above referred persons – exception has been carved out for scheduled banks, asset reconstruction companies registered with RBI under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, and alternative investment funds registered with SEBI.

Any person falling in the aforesaid category would be rendered ineligible as a resolution applicant and as a necessary corollary ineligible to propose a scheme of arrangement during the liquidation stage.

Recourse to Section 230 of Companies Act

The corporate insolvency resolution process is a process to revive and rehabilitate the debt-ridden company, failure of which results in death of a corporate debtor company i.e liquidation. However, even at the stage of liquidation, an opportunity has been provided to once again restructure/rehabilitate the corporate debtor company by taking recourse to Section 230 of the Companies Act. Interestingly, it is the adjudicating and the appellate authority that transported this beneficial provision from the Companies Act to IBC (Code). Pertinently, the scheme of compromise and arrangement has always been available under the Companies Act for restructuring a debt ridden company. The concept of restructuring by proposing a scheme under the Code first came to light in the matter of *S.C. Sekaran vs. Amit Gupta & Ors.*² wherein the NCLAT directed the liquidator to take steps under Section 230 of the Companies Act, 2013 including considering

² *Company Appeal (AT)(Insolvency) No. 495/496 of 2018*

any application for compromise or arrangement before actually selling the assets of the corporate debtor. The NCLAT drew inspiration from the rulings of the Hon'ble Supreme Court in the matters *Swiss Ribbons Pvt. Ltd. v. Union of India*³ and *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*⁴ wherein the Supreme Court observed that “*the liquidator may also sell the corporate debtor as a going concern*”. The NCLAT perhaps was guided by the underlying principle of IBC i.e. ‘resolution over liquidation’. The NCLAT has followed its diktat in *S.C. Sekaran* in several subsequent appeals including *Ajay Agarwal v. Ashok Magnetic Ltd*⁵, *Rajesh Balasubramanian v. Everon Castings Pvt. Ltd*⁶. and *Y. Shivram Prasad v. S. Dhanapal*⁷.

The NCLAT's ruling in *R. Vijay Kumar & Anr. v. Kasi Viswanathan & Anr*⁸ prompted the IBBI to deliberate on the aspect as to whether a promoter is eligible to participate in the scheme of arrangement at liquidation stage. In the said judgment the NCLAT upheld the decision of NCLT, Chennai which had rendered the promoter of the corporate debtor ineligible as per Section 29A of the Code to bid in the resolution process and passed the order for liquidation. The NCLAT however, directed the Liquidator to act in terms with the decision of *Y. Shivram Prasad* before liquidating the corporate debtor as per the Code. Interestingly, the IBBI took the liberal approach and was of the view that there will be practical difficulties in implementation of ineligibility for the purposes of Section 230 of the Companies Act and accordingly proposed that the ineligibility norms under section 29A of the Code may not apply to compromise or arrangement under Section 230 of the Companies Act⁹. This view of IBBI was certainly contrary to the spirit of IBC as it sought to give a leeway to the errant promoters to regain control of the company who were the reason behind the collapse of the corporate debtor company.

The view of IBBI to relax the ineligibility norms under Section 29A during the liquidation stage was not perceived well by the NCLAT and rightly so as non-applicability of Section 29A at the stage of compromise or arrangement would have undermine the processes and rewarded unscrupulous persons at the expense of the creditors. The conundrum for the first time was put to an end by the Hon'ble NCLAT in *Jindal Steel and Power Limited v. Arun Kumar Jagatramka & Gujarat NRE Coke Limited*¹⁰ wherein it was clarified that persons ineligible under Section 29A are not qualified to propose a scheme during liquidation. Following the judgment in *Gujarat NRE Coke*, the IBBI was once again prompted to invite comments from the public *inter alia* on the following issues as a need was felt to harmonize the provisions in the Code and the Companies Act so as to provide level playing field: (i) should the persons ineligible under Section 29A of the

³ *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India & Ors.*, AIR2019SC739

⁴ *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta.*, Civil Appeal Nos.9402-9405 of 2018

⁵ *Company Appeal (AT) (Insolvency) No. 793 of 2018*

⁶ *Company Appeal (AT) (Insolvency) No. 182 of 2019*

⁷ *Company Appeal (AT) (Insolvency) No. 224 of 2018*

⁸ *Company Appeal (AT) (Insolvency) No. 340 of 2019*

⁹ *IBBI's Discussion Paper on Corporate Liquidation Process along with Draft Regulations dated April 27, 2019*

¹⁰ *Company Appeal (AT) No. 221 of 2018 dated 24.10.2019*

Code from becoming a resolution applicant be barred from becoming a party in compromise or arrangements under Section 230 of the Companies Act, 2013 and (ii) should applicability of Section 230 of the Companies Act, 2013 during liquidation process under the Code be reviewed¹¹. The conundrum arising out of the following issues were finally concluded by way of the amendment to the Liquidation Regulations by clarifying that persons not eligible under the Code to submit a resolution plan for insolvency resolution of the corporate debtor shall not be a party in any manner for proposing any scheme of compromise or arrangement.

Conclusion

The scheme of compromise and arrangement, though historically present in the Companies Act have regained prominence as a means to restructure the debt-ridden company. The NCLT and NCLAT in a catena of judgments have directed the Liquidator to take steps in terms of Section 230 of the Companies Act before actually liquidating the assets of the company. There was no explicit prohibition, until the amendment, on persons ineligible to submit resolution plans under Section 29A of the Code from proposing a compromise or arrangement under Section 230 of the Companies Act. This gave a leeway to persons ineligible under Section 29A to acquire control of the corporate debtor. One possible argument which may have prompted IBBI to initially propose relaxing the 29A rule during the scheme of arrangement could have been that when the company fails the resolution process as there are no buyers or bidders in the market; then instead of liquidating the company why not give it back to the promoters for the reason that (i) promoter may infuse money over and above the liquidation value of the company (ii) jobs of employees remain intact and (iii) liquidation is an exception to the object of IBC. The aforesaid ground though seems to be a plausible argument is nonetheless against the spirit of IBC because the spirit is that those responsible behind the downfall of the company should not be allowed to regain control of the company. Even if one looks at Section 35 of the Code, sale of assets in Liquidation cannot take place to the promoters of the corporate debtor company. The 06.01.2020 amendment has closed all doors for the ineligible promoters who potentially sought to take back control through the backdoor route i.e. during the liquidation stage.

¹¹ IBBI's Discussion Paper on Corporate Liquidation Process along with Draft Regulations dated December 03, 2019