RECENT UPDATES: INSOLVENCY AND BANKRUPTCY CODE

Yashika Sarvaria

I. ***Interpretation of Section 29A:*** In order to prevent unscrupulous promoters from buying back the corporate debtor at low discounted prices, Section 29A was incorporated in the Insolvency and Bankruptcy Code ("Code") with retrospective effect from 23rd November 2017 and then amended on 6th June 2018. Section 29A provides for the eligibility criteria to determine persons who are eligible to submit a Resolution Plan.

While considering the eligibility of Arcelor Mittal India Private Limited and Numetal Limited to submit a resolution plan for Essar Steel India Limited, the Supreme Court of India vide its recent decision in the matter of *Arcelor Mittal India Private Limited* v. *Satish Kumar Gupta* interpreted a number of provisions and issues concerning Section 29A of the Code. The key highlights of the judgment are as under:

a) The opening lines of Section 29A refer to a *de facto* as opposed to a *de jure* position of the persons mentioned therein. This is a typical instance of a "*see through provision*", so that one is able to arrive at persons who are actually in "*control*", whether jointly, or in concert, with other persons. A purposeful and contextual interpretation of section 29A is imperative to find out the real individuals or entities who are acting jointly or in concert for submission of a resolution plan.

b) **Meaning of "acting jointly":** For "acting jointly", what is to be ascertained is whether certain persons have got together and are acting jointly in the sense of acting together. If this is made out on the facts, no added element of 'joint venture' is to be seen.

c) **Definition of "in concert":** The Code adopts definitions from the SEBI Act, 1992. As such the definition of 'acting in concert' from the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 is consequently applicable. The term "Acting in concert" includes any understanding, even if it is informal, and even if it is to indirectly co-operate to exercise control over a target company.

d) **Stage of ineligibility:** The question before the Court was whether the ineligibility is to be seen on the date of commencement of Corporate Insolvency Resolution Process ("CIRP") or when the plan is submitted by the resolution applicant. The Court observed that the opening words of Section 29A state that, *"a person shall not be eligible to submit a resolution plan…",* which shows that the stage of ineligibility attaches when the resolution plan is submitted by a resolution applicant. The date of commencement of the CIRP is only relevant for the purpose of calculating whether one year has lapsed from the date of classification of a person as a non-performing asset. Consequently, the amendment of 2018 introducing the words "at the time of submission of the resolution plan" is clarificatory, as this was always the correct interpretation as to the point of time at which the disqualification in sub-clause (c) of Section 29A will attach.

e) **Management and control:** The ingredients of sub-clause (c) are that, the ineligibility to submit a resolution plan attaches if any person, as is referred to in the opening lines of Section 29A, either itself has an account, or is a promoter of, or in the management or control of, a corporate debtor which has an account, which account has been classified as a non-performing

asset, for a period of at least one year from the date of such classification till the date of commencement of the CIRP. For the purpose of applying this sub-section, any one of three things, which are disjunctive, needs to be established. The corporate debtor may be under the management of the person referred to in Section 29A, the corporate debtor may be a person under the control of such person, or the corporate debtor may be a person of whom such person is a promoter. The expression "management" would refer to the *de jure* management of a corporate debtor. The *de jure* management of a corporate debtor would ordinarily vest in a Board of Directors, and would include, in accord with the definitions of "manager","managing director" and "officer" in Sections 2(53), 2(54) and 2(59) respectively of the Companies Act, 2013, the persons mentioned therein.

The expression "control", in Section 29A(c), denotes only positive control, which means that the mere power to block special resolutions of a company cannot amount to control. "Control" here, as contrasted with "management", means de facto control of actual management or policy decisions that can be or are in fact taken. Section 29A(c) speaks of a corporate debtor "*under the management or control of such person*". The expression "*under*" would seem to suggest positive or proactive control, as opposed to mere negative or reactive control. This becomes even clearer when sub-clause (g) of Section 29A is read, wherein the expression used is "*in the management or control of a corporate debtor*". Under sub-clause (g), only a person who is in proactive or positive control of a corporate debtor can take the proactive decisions mentioned in sub-clause (g), such as, entering into preferential, undervalued, extortionate credit, or fraudulent transactions.

It is thus clear that in the expression "*management or control*", the two words take colour from each other, in which case the principle of *noscitur a sociis* must also be held to apply. Thus, what is referred to in sub-clauses (c) and (g) is *de jure* or *de facto* proactive or positive control, and not mere negative control which may flow from an expansive reading of the definition of the word "*control*" contained in Section 2(27) of the Companies Act, 2013, which is inclusive and not exhaustive in nature.

f) **Challenge by a Resolution Applicant:** Where a resolution plan is turned down at the threshold by a Resolution Professional, no challenge can be preferred to the Adjudicating Authority at this stage. A writ petition under Article 226 filed before a High Court would also be turned down on the ground that no right, much less a fundamental right, is affected at this stage. An aggrieved resolution applicant can approach the NCLT for relief only after a resolution plan has been considered by the Committee of Creditors ("CoC") after voting and not prior to that.

g) **Examination of resolution plan by Resolution Applicant-** The Resolution Professional is required to examine that the resolution plan submitted by various applicants is complete in all respects, before submitting it to the CoC. He is not required to take any decision, but merely to ensure that the resolution plans submitted are complete in all respects before they are placed before the CoC, who may or may not approve it. The fact that the Resolution Professional is also to confirm that a resolution plan does not contravene any of the provisions of law for the time-being in force, including Section 29A of the Code, only means that his *prima facie* opinion is to be given to the CoC that a law has or has not been contravened. Section 30(2)(e) does not empower the Resolution Professional to 'decide' whether the resolution plan does or does not contravene the provisions of law. Even though it is not necessary for the Resolution Professional to give reasons while submitting a resolution plan to the CoC, it would be in the fitness of things if he appends the due diligence report carried out by him with respect to each

of the resolution plans under consideration, and to state briefly as to why it does or does not conform to the law.

It is the CoC which will approve or disapprove a resolution plan, given the statutory parameters of section 30. The disapproval of the CoC on the ground that the resolution plan violates the provisions of any law, including the ground that a resolution applicant is ineligible under Section 29A, is not final. The Adjudicating Authority, acting quasi-judicially, can determine whether the resolution plan is violative of the provisions of any law, including section 29A of the Code, after hearing arguments from the resolution applicant as well as the CoC, after which an appeal can be preferred from the decision of the Adjudicating Authority to the Appellate Authority under section 61. If, on the other hand, a resolution plan has been approved by the CoC, and has passed muster before the Adjudicating Authority, this determination can be challenged before the Appellate Authority under section 61 and may further be challenged before the Supreme Court under section 62, if there is a question of law arising out of such order.

h) **Scope of interference by NCLT –** Section 60(5) of the Code does not invest the NCLT with the jurisdiction to interfere at an applicant's behest at a stage before the quasi-judicial determination made by the Adjudicating Authority. The non-obstante clause in section 60(5) is designed for a different purpose i.e. to ensure that the NCLT alone has jurisdiction when it comes to applications and proceedings by or against a corporate debtor.

II. Retrospective effect of Section 238A – Section 238A was inserted by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 with effect from 06.06.2018. Section 238A provides that the provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal, the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal, as the case may be. In ***B.K. Educational Services Private Limited v. Parag Gupta and Associates***, the question before the Apex Court was whether the Limitation Act, 1963 will apply to applications that were made under Section 7 and/or Section 9 of the Code on and from its commencement on 01.12.2016 till 06.06.2018, where the Appellate Authority had held that the provisions of Limitation Act, 1963 are not applicable. The Supreme Court held that the amendment of Section 238A would not serve its object unless it is construed as being retrospective, as otherwise, applications seeking to resurrect time-barred claims would have to be allowed, not being governed by the law of limitation.

III. Continuation of the suit proceedings as per Section 14 of the Code includes taking procedural steps such as filing of written statement – In ***M/s. Golden Jubilee Hotels Limited v. M/s. EIH Ltd. and another****, 2018 SCC OnLine Hyd 315*, the trial Court had opined that mere filing of written statements would not violate the order of the NCLT and observed that though the Civil Court could not pass any adverse order fastening any liability, the mere making of an appearance by the defendants and putting forth their case would not be violative of the moratorium. The trial Court had further opined that it had discretion to receive the written statements and pass any procedural orders which would not be in conflict with the order of the NCLT. Another justification that was given by the trial court was that the written statements of the defendants would assist the interim resolution professional to resolve the dispute for

which the defendants were using delaying tactics. Negating the observations and decision of the trial Court, the High Court of Andhra Pradesh *inter alia* held that requiring the filing of a written statement would be a step in continuation of the suit proceedings and the same would be violative of Section 14 of the Code. Continuation of the suit proceedings would encompass every step therein, which would include not only adjudicatory steps but also procedural ones. Upon the moratorium order being passed, the pending suit proceedings necessarily had to come to a complete halt. It was further observed that the interim resolution professional is not required to play an adjudicatory role in terms of testing the claims of the creditors against the corporate debtor and the question of the written statements filed by the defendants assisting him in resolving the dispute does not arise.

IV. Continuation of proceedings against the Director of the Corporate Debtor not permissible where the cause of action against the Corporate Debtor and the Director are inextricably linked - Another issue in ***M/s. Golden Jubilee Hotels Limited v. M/s. EIH Ltd. and another,*** was with regard to the continuation of suit against the Director of the company. In this case, the company was impleaded as the first defendant and the second defendant in the suit was the Director and CEO of the defendant company. The trial Court, in its order had observed that as he is an individual, the moratorium order would not apply to him. The High Court however noted that the plaint averments clearly demonstrate that the suit claim was directed against the first defendant company and it is only in the capacity of being its CEO that the second defendant was impleaded. It was also noted that the cheques on the strength of which the summary suit was filed were issued by the first defendant company. Accordingly, the High Court held that Section 14 of the Code of 2016, as it presently reads after its amendment, vide the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, with retrospective effect from 06.06.2018, only excludes the surety in a contract of guarantee to a corporate debtor from the ambit of a moratorium order. There is no mention of individual Directors of the corporate debtor being immune from the moratorium order. The Court noted that it is the normal practice to implead in a suit or proceeding not only the corporate entity but also its Managing Director or Chief Executive Officer. This would not mean that the cause of action against such Managing Director or Chief Executive Officer is independent of and separate from the claim against the corporate entity itself. The claim of the plaintiff company is essentially directed against the first defendant company and the acts imputed to the second defendant, its Director & CEO, are inextricably linked therewith. It was accordingly held that the question of allowing the suit proceedings to go on independently against the second defendant, while giving effect to the moratorium order dated 27.02.2018 against the first defendant company alone, would not arise.

V. Voting threshold for decision of the committee of creditor by sixty six percent would not be mandatory where the prospective buyers of Real Estate (Commercial & Residential) alone constitute the CoC: In ***Nikhil Mehta & Sons (HUF) & others v. M/s AMR Infrastructures Ltd.*,** an application was filed under Section 60(5) of the Code by the interim resolution professional regarding the deadlock created by low percentage of votes casted by a new category of financial creditor recognised by Amendment Act of 2018. In the CIRP:

- With regard to ratification of cost of interim resolution professional, 55.48% of the votes were casted in favour of the resolution and 44.16% of the votes were casted against the resolution.
- With regard to appointment of interim resolution professional as resolution professional, 61.69% of the votes were casted in favour of the resolution and 38.31% of the votes were casted against the resolution.

- With regard to the fixing of expenses to be incurred on or by the resolution professional and source of finding for the expenses, 59.25% of the votes were casted in favour of the resolution and 40.75% of the votes were casted against the resolution.
- With regard to raising of interim finance to fund CIRP cost, 62.56% of the votes were casted in favour of the resolution and 37.44% of the votes were casted against the resolution.
- With regard to decision regarding change of management, 98.79% of the votes were casted in favour of the resolution and 1.21% of the votes were casted against the resolution.
- With regard to banking arrangements for AMR Infrastructures Ltd., 97.39% of the votes were casted in favour of the resolution and 2.61% of the votes were casted against the resolution.

In view of the aforesaid deadlock, the interim resolution professional expressed his inability to proceed further as neither the Code nor the Regulations framed there under provided any specific guidance for Resolution of the deadlock. Given the circumstances the NCLT observed that the Real estate (Commercial & Residential) creditors are a class of creditors distinct from the well organised financial creditors like banks, financial institutions, asset reconstruction companies etc. Merging of categories of all financial creditors and treating them one would amount to treating unequals as equals which may result in violation of Article 14 of the Constitution. As such providing the same threshold for both categories may result to a declaration that those provisions are ultra vires of Article 14 of the Constitution. Accordingly, the NCLT while adopting a workable interpretation of the Code *inter alia* held that the threshold voting share for decision of the CoC by sixty six percent would not be mandatory in the cases of class of creditors where the prospective buyers of Real Estate (Commercial & Residential) alone constitute the CoC. It was further held that in case of deadlock the preference can be given to the decisions taken by the highest percentage in the CoC and Section 22(2) must be regarded as directory in nature in case CoC is comprised 100% of class of creditors Real Estate (Commercial & Residential). It was held:

> *"Therefore, we are of the view that in the case of Real Estate (Commercial & Residential) comprising 100% voting share in the CoC the aforesaid provision must be read to mean that a resolution would be deemed to be passed if it is voted by highest number of financial creditors in the class of Real Estate (Commercial & Residential). It would make the Code workable and would also advance the object of this progressive legislation rather than defeating it…"*