IBC16
INSOLVENCY AND BANKRUPTCY CODE, 2016

IBC16's Easy Explainers

Section 29A of IBC, 2016

ABBREVIATIONS & ACRONYMS USED

Committee of Creditors	CoC
Corporate Debtor	CD
Corporate Insolvency Resolution Process	CIRP
Financial Creditor	FC
Operational Creditor	OC
The Insolvency and Bankruptcy Board of India	IBBI
Insolvency and Bankruptcy Code, 2016	the Code
National Company Law Appellate Tribunal	NCLAT
National Company Law Tribunal	NCLT
Resolution Professional	RP

Introduction

The Code primarily aims to facilitate the resolution and revival of a distressed CD. To that end, the Code provides for the invitation of resolution plans from prospective resolution applicants. A resolution applicant is defined under Section 5(25) of the Code as a person who individually, or jointly with any other person, submits a resolution plan to the RP in response to the invitation made under Section 25(2)(h). Resolution plans can be invited only from the prospective resolution applicants who fulfill the eligibility criteria laid down by the RP, with the approval of the CoC. The criteria should take into consideration the complexity and scale of operations of the business of the CD, and such other conditions as may be specified by the IBBI.

In addition to meeting the eligibility criteria, the resolution applicant shall not be ineligible under Section 29A of the Code. Section 29A was introduced by way of the Insolvency and Bankruptcy Code (Amendment) Act, 2018, with retrospective application from November 23, 2017. Before the 2018 amendment, any person could present a resolution plan for a CD, irrespective of whether they were the original promoter, director, or any person connected to them directly or indirectly. As a result, persons who, by their misconduct or fraudulent motives, contributed to the default of the CD, could regain control of their company by bidding in heavy discounts while banks and other financial institutes took haircuts. They could misuse the Code to participate in the resolution or liquidation process, and gain or regain control of the CD.

The government decided that such unscrupulous people could undermine the Code, by appearing to be rewarded at the expense of creditors. Thus, Section 29A was introduced to disqualify those who had contributed to the downfall of the CD, or who were otherwise unsuitable to run the company because of their antecedents, whether directly or indirectly.

Need for Section 29A

Section 29A, being a restrictive provision, specifically lists down the persons who are not eligible to be resolution applicants. It not only restricts the promoters, but also the people related/connected with them. The intention behind inserting Section 29A is to restrict those persons from submitting a resolution plan who could have an adverse effect on the entire CIRP. Section 29A is also relevant to the sale during liquidation, as well as sale outside the liquidation process, and participation in a scheme of arrangement during liquidation processes. The provision aids in adhering to the timelines under the Code, which were otherwise being violated due to the loopholes in the bidding process. Upon commencement of the resolution process under the Code, the board of directors of the CD stands immediately suspended, and its powers and rights are vested in and exercised by, the Insolvency Professional. While the directors are entitled to attend the meetings of the CoC, such directors have no voting rights and neither are their recommendations binding on either the RP, or any member of the CoC.

However, the NCLT, Mumbai Bench, gave a ruling in the matter of Wig Associates Private Limited that completely disregarded the wording of Section 29A.

It allowed the resolution plan offered by an applicant who was related to the director(s) of the CD which had triggered CIRP against itself through a Section 10 application. It appeared that Bank of Baroda, being the sole financial creditor, and the CD reached a one-time settlement with Mr. Mahindra Wig for settlement of the outstanding amounts. To comply with the provisions of the Code, Wig offered a resolution plan which was approved by the Bank of Baroda, which was later submitted following an Expression of Interest (EOI) floated in April 2018, after the IBC Amendment Act, 2018 was passed. The wig was a 'connected person' as per the provisions of Section 29A of the Code, which made him ineligible to submit a plan as a resolution applicant under the IBC Amendment Act, 2018. The bench, however, observed that CIRPs are continuous in nature, which commences from the time of admission and ends only when a final order is passed, either allowing a resolution plan or initiating liquidation. Thus, once commenced, a CIRP cannot be halted, altered, or changed till its finalization. It is evident that this decision completely ignored the intention behind introducing Section 29A. The provisions of Section 30(4), also inserted by the amendment act, clearly stated that "[P]rovided that the committee of creditors shall not approve a resolution plan submitted before the commencement of the Insolvency and Bankruptcy Code (Amendment Ordinance) 2017 (Ord. 7 of 2017), where the resolution applicant is ineligible under section 29A and may require the resolution professional to invite a fresh resolution plan where no other resolution plan is available with it", had also been ignored by the ruling.

While commenting on the importance of Section 29A, the Supreme Court in Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr observed that it was enacted keeping in mind the larger public interest and to facilitate effective corporate governance. The Court noted that the provision closed a loophole that was allowing a backdoor entry into the CIRP to the erstwhile management of CDs.

Who is ineligible under Section 29A?

According to Section 29A, a person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person is suffering from the disqualifications as mentioned below:

a) They are an undischarged insolvent;

b) They are a 'Wilful Defaulter' in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 (10 of 1949);

c) They have 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 a non-performing asset (NPA) in accordance with RBI Guidelines issued under the Banking Regulation Act, 1949 and at least a period of 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 the resolution plan;

d) They have been convicted for any offense punishable with imprisonment for two years or more;

e) They are disqualified to act as a director under the Companies Act, 2013;

f) They are prohibited by SEBI from trading in securities or accessing the securities markets;

g) They have 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;

h) They have 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;

I) They have been subject to the above-listed disabilities under any law in a jurisdiction outside India;

j) They have a connected person, i.e. persons connected to the person disqualified under any of the aforementioned points, such as those who are promoters or in management of control of the resolution applicant, or will be promoters or in management of 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 Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, and alternative investment funds registered with SEBI.

An analysis of Section 29A reveals that the Code envisages four layers of ineligibility as mentioned below:

1. Fist layer, wherein the person itself is ineligible;

2. Second layer, wherein a person “connected” to such person is ineligible;

3. Third layer; wherein a party “related” to the ineligible person is also ineligible;

4. Fourth layer, wherein a person acting jointly/in concert with a person suffering from the first, second or third layer of ineligibility, also becomes ineligible.

Analysis

Section 29A of the Code has become the primary test for determining the eligibility of resolution applicants in a CIRP. The Code, in its original form, did not have any provisions to prevent defaulting promoters from buying back the CD, potentially at steep discounts. Earlier, a ‘resolution applicant’ under Section 5(25) meant any person who submitted a resolution plan to the RP. It could be any person – a creditor, a promoter, a prospective investor, an employee, or any other person. The 2018 amendment modified the definition to mean a person who, individually or jointly, submits a resolution plan to the resolution professional pursuant to the invitation made under section 25(2)(h) of the Code.

Section 29A is a restrictive provision, in the sense that any person falling in the negative list is not eligible to submit a resolution plan. Therefore, in order to be eligible to submit a resolution plan, a person:

➔ shall fulfill the criteria laid down by the resolution professional with the approval of the committee of creditors; and
➔ shall not suffer from any disqualification mentioned under section 29A.

The Supreme Court discussed the application and scope of Section 29A in Anuj Jain IRP for Jaypee Infratech vs. Axis Bank Ltd. In this case, Jaiprakash Associates Ltd. (JAL), the parent company of Jaypee Infratech Ltd., had submitted a resolution plan. The Supreme Court observed that JAL and other promoters were disqualified from submitting a resolution plan as they fell within the scope of Section 29A, and were therefore ineligible. The Court described the insertion of Section 29A as 'plugging a loophole', ruling that strict adherence to Section 29A was mandatory, and that willful defaulters shall not be permitted to participate in the CIRP.

NPA Criteria

Clause (c) of Section 29A debars a person or a person acting jointly or in concert with such person who –

1. has an account classified as NPA;

2. is a promoter of a corporate debtor, the account of which has been classified as NPA;

3. is in the management of a corporate debtor, the account of which has been classified as NPA;

4. is in control of a corporate debtor, the account of which has been classified as NPA.

A period of at least one year should have elapsed from the date of such classification till the insolvency commencement date. In Arcelor Mittal India Pvt. Ltd. vs. Satish Kumar Gupta & Ors., the apex court interpreted this clause and analyzed the definition of "control", observing that it denoted only positive control. The Court observed that great care must be taken in respect of this clause to ensure that persons who were in charge of the CD do not come back in some other form, to regain control of the company without first paying off its debts. Therefore, any company (including the promoters/persons in the management of or control of such company) which has its account classified as NPA for the last one year will not be able to submit a resolution plan. However, the Code provides for an exception – such a person shall be eligible to submit a resolution plan if they pay all overdue amounts with interest, and also pay the charges relating to NPA accounts, before submitting a plan.

The Insolvency Law Committee, which was set up to make recommendations to the Government on issues concerning the implementation of the Code, recognized in its March 2018 report that ARCs, AIFs, IVs, etc. could, by virtue of the nature of their business, be classified as NPAs under 29A(c), and be subject to disqualification. Hence an explanation for 'financial entities' which would be exempt from the ambit of the clause, was proposed. The possibility of acquiring NPAs due to past CIRPs was considered, and a time-limit of three years from the time of acquisition was proposed within which such NPAs acquired in a CIRP would not be hit by 29A(c).

Vulnerable Transactions

Clause (g) of Section 29A disqualifies a promoter/person in the management or control of a CD in which a preferential transaction (Section 43), undervalued transaction (Section 45), extortionate credit transaction (Section 50), or fraudulent transaction (Section 49) has taken place, and the adjudicating authority has passed an order on it. The provision is qualified to the extent it uses the term "corporate debtor", and that the adjudicating authority should have passed an order under the Code. This clause does not apply if any of these transactions have taken place prior to the acquisition of the CD by the resolution applicant pursuant to a resolution plan approved under the Code, or pursuant to a plan approved by a financial sector regulator or a court, and such resolution applicant has not otherwise contributed to the transaction.

While deliberating on this provision, the Insolvency Law Committee opined that the acts of predecessors should not impede those in management or in control from submitting plans. The Committee thus suggested that a proviso, similar to that of NPAs, must be inserted stating that if such a transaction has taken place in an entity acquired through CIRP, and such an action took place prior to such acquisition, this clause will not apply.

Role of a Guarantor to CD

Clause (h) of Section 29A bars such persons from submitting a resolution plan who have guaranteed the obligations of the insolvent CD. It covers a person who has executed a guarantee in favor of a creditor for a CD under CIRP initiated by that creditor, and that guarantee has been invoked by the creditor and it remains unpaid in full or in part.

The provision came up for discussion in RBL Bank Ltd. v. MBL Infrastructures Ltd., wherein the resolution applicants submitted that purporting to disqualify the entire class of guarantors under the said clause would violate their valuable rights. They argued that if the guarantee is not invoked and demand is not made on the guarantor, the debt payable by him is not crystallized and the guarantor cannot, therefore, be said to be in breach of the guarantee. Such guarantor thus must not be penalized merely because a legal and binding contract of guarantee exists, which is otherwise impossible but is subject to its invocation in accordance with the terms of the guarantee. The NCLT agreed to the view observing that the guarantors against whom a creditor has not invoked the guarantee, or made a demand under it, should not be disqualified under Section 29A.

The NCLT noted that it could not be the intent of clause (h) to penalize those guarantors who have not been offered an opportunity to pay up, as their guarantees have not been invoked. Therefore, the words “enforceable guarantee” appearing in clause (h) are not to be understood by their ordinary meaning or in the context of enforceability of the guarantee as a legal and binding contract, but in the context of the objectives of the Code in general, and clause (h) in particular.

The Insolvency Law Committee took a similar view while preparing its report, and opined that the intent of the provision is not to disqualify all guarantors merely for the presence of an enforceable guarantee. Hence, the Committee suggested that the term “enforceable” be deleted from the clause. Thus, the guarantee must be invoked by the creditor and must subsequently remain unpaid in part or in full, for disqualification under this clause.

MSME Exemptions

When Section 29A was inserted, concerns were raised about whether there would be non-promoter resolution applicants interested in the resolution of micro, small, and medium enterprises (MSMEs). While section 29A was not limited to promoter disqualification, in practice, since the majority of companies undergoing the CIRP would have NPAs more than a year old or the promoters would have given a guarantee to the lenders, most promoters would end up being disqualified under section 29A(c) (the NPA disqualification) or section 29A(h) (the guarantee disqualification).

Given the importance of MSMEs and recognizing that promoters of an MSME are likely to be interested in acquiring it, the government restricted the applicability of Section 29A by way of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (later replaced by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018), which introduced section 240A to the Code. The provision excludes MSMEs from the operation of Sections 29A(c) and 29A(h) of the Code. This means that promoters of MSMEs can be the resolution applicants for MSMEs undergoing CIRP, even if these promoters are otherwise disqualified under section 29A(c) or section 29A(h) (and assuming they are not disqualified under any other provision of section 29A).

As per a notification dated June 26, 2020, issued by the Ministry of Micro, Small, and Medium Enterprises, effective July 1, 2020, an enterprise shall be classified

- as a micro-enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;

- a small enterprise, where the investment in plant and machinery or equipment does not exceed 10 crore rupees and turnover does not exceed 50 crore rupees;

- and a medium enterprise, where the investment in plant and machinery or equipment does not exceed 50 crore rupees and turnover does not exceed 250 crore rupees.

In Saravana Global Holdings Ltd. & Anr. vs. Bafna Pharmaceuticals Ld. & Ors., the Supreme Court upheld the order of the NCLAT which had held that the CD was an MSME and the promoters were not ineligible in terms of Section 29A of the Code. Therefore, it was not necessary for the CoC to find out whether the resolution applicant was ineligible in terms of Section 29A.

Other Landmark Decisions

In Arcelormittal India Pvt. Ltd. vs. Satish Kumar Gupta, the Supreme Court delved into the interpretation of Section 29A and held it was a de facto, as opposed to de jure, position of persons mentioned in it. The Court observed that it was a 'typical see-through provision', so that one could see persons who were actually in 'control' of the CD, whether jointly or in concert with other persons. The Court thus noted that a purposeful and contextual interpretation of Section 29A was imperative to pierce the corporate veil, to find out who were the real individuals or entities acting jointly or in concert for submission of a resolution plan. The Court also noted that an RP must only "examine" and "confirm" that a resolution plan conforms to the parameters of Section 30(2), before presenting the plan to the committee of creditors under Section 25(2)(i) r/w Section 30(3). It held that in the event a resolution professional forms an opinion that a resolution plan contravenes any provisions of the law, including Section 29A, he or she is only expected to present an opinion before the committee of creditors and not render a decision regarding the validity of a resolution plan. The Court thus clarified that in order to establish the eligibility of a resolution applicant for submitting a resolution plan, it must be determined at the very moment of the submission, and in accordance with the parameters of Section 29A applicable at the time.

In Swiss Ribbons v. Union of India, various challenges were raised against the validity of Section 29A. The validity of this section was challenged firstly on the ground that the retrospective application of Section 29A prejudiced the vested rights of erstwhile promoters to participate in the resolution process, as well as the liquidation process. The Court rejected this argument and held that since there was no vested right of the resolution applicant for approval or consideration of their resolution plan, no vested right was taken away by the retrospective application of 29A. Additionally, it was argued that Section 29A(c) treated unequals as equals by treating promoters who did not act with malfeasance on par with those who had. The Court held that Section 29A was intended to apply to persons other than criminals or those who had displayed malfeasance, and this was justified by the legislative purpose of the section. It was also argued that the period of one year prescribed in Section 29A(c) for the disqualification to apply was arbitrary. The Court opined that a person who was unable to service their own debt even after the grace period of a year, was unfit to become a resolution applicant. The petitioners also argued that a person, who was otherwise qualified to be a resolution applicant, could not be held to be ineligible to be a resolution applicant under Section 29A(j) merely because he was a relative of an ineligible person. The Court examined the definition of “related party” under Section 5(24A) of the Code, and noted that such persons must be “connected” with the business activity of the resolution applicant within the meaning of Section 29A(j). If this could not be shown, such a person would not be disqualified under section 29A(j). Thus, the applicability of section 29A to related parties was restricted.

Lastly, it was argued that the exemption of MSMEs from Section 29A was arbitrary. The Court held that it was not arbitrary since "the rationale for excluding such industries from the eligibility criteria laid down in Section 29A(c) and 29A(h) was because qua such industries, other resolution applicants may not be forthcoming, which then will inevitably lead not to resolution, but to liquidation." With this, the constitutionality of Section 29A of the Code was upheld.

In SBI Global Factors Ltd. V/s. Sanaa Syntex Private Limited, the NCLT Mumbai bench deliberated on whether Section 29A was applicable to liquidation proceedings where the secured creditor had realized the security interest on its own. The Tribunal noted that the defaulters disqualified under Section 29A should not get any benefit under the Code. A defaulter must thus not be benefitted by entering into those very assets through side doors, when they were otherwise not permitted to enter them from the front doors, for e.g. by submission of a resolution plan. The bench relied on Swiss Ribbons and held that the provisions of S. 29A continue to apply not merely to resolution applicants, but to liquidation as well. The Tribunal thus answered the question in affirmative and held that the secured creditor availing its option under Section 52 of the Code should not sell the assets to the erstwhile promoters/directors.

In Harkirat Singh Bedi vs. The Oriental Bank of Commerce & Ors., the NCLAT dealt with a matter related to Section 29A(b) of the Code. In this case, the appellant had submitted a resolution plan, which was rejected by the CoC on the ground that it was a wilful defaulter, thus being ineligible under Section 29A(b). In appeal, it contended that it was declared a wilful defaulter by SBI, State Bank of Travancore and Oriental Bank of Commerce, without following the guidelines of RBI. The NCLAT held that the determination of a wilful defaulter was outside its jurisdiction; that the RP could not go into the correctness or incorrectness of the declaration as a wilful defaulter, and could only rely on the current status of the resolution applicant. The appellant claimed the advantage of Section 240A exempting the applicability of Section 29A. The NCLAT observed that the exemption was available only in respect of clauses (c) and (h) of section 29A, and not 29A(b).

Concluding Remarks

Section 29A has laid down a multi-layered and comprehensive standard of disqualification, which might sometimes exclude bona fide resolution applicants. The application of the section might also disbar crucial stakeholders from bidding for the revival of the company. Therefore, a certain amount of leniency by the courts in deciding the issue of disqualification may be helpful. As an alternative to the current restriction, a middle ground could be adopted, which permits promoters to bid for the corporate debtor, while ensuring there are sufficient safeguards in place to ensure that the lenders make the most of the resolution process. This will make CIRP much more viable economically for the promoters and the lenders, without compromising the sanctity of the process. It is necessary to ensure that the citadel of insolvency resolution does not have holes in its ramparts, but it should also not be inaccessible, with no gates, drawbridges or ladders.