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A REVIEW OF SECTION 29A (D) OF INSOLVENCY AND BANKRUPTCY CODE (IBC) 2016

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Abstract:

After getting the President's approval, the IBC went into effect in 2016. It has developed into a thorough piece of legislation with a swift and precise mechanism for handling the insolvency issue. Since then, there have been numerous ordinances and IBC changes, and the law has been changing.

One of the primary purposes of the code is to provide the corporate debtor with a strategy for resolution. At one time, anybody who submitted a proposed resolution to the resolution expert was considered a resolution applicant. Any proposal to help a company emerge from bankruptcy was considered a resolution plan. Due to the lack of clear requirements or qualifications, any party, including the corporate debtor's promoters or any linked party, was free to propose a resolution plan. This plan received a lot of criticism because of the way the code's broad scope acted as a loophole and allowed the promoters to acquire access to the corporate debtor's management.

Instead of liquidation, the code advocates for insolvency resolution. The law was created with the goal of facilitating fair discussions between opposing parties, speeding up and streamlining the insolvency and bankruptcy proceedings in India, and assisting in the encouragement of corporate resurrection through the creation of resolution plans

The government first adopted the IBC (Amendment) Ordinance, 2017, to address the problem, and then passed the IBC (Amendment) Act, 2018, to formally insert Sec. 29A into the Code.

Keywords:

IBC, Corporate Debtor, Sec. 29(A)

Introduction:

For the purposes of the Corporate Insolvency Resolution Process, Sec. 29A of the IBC, 2016 is a critical piece of legislation. At first, there was nothing in the Code to stop defaulting promoters from repurchasing the corporate debtor at steep discounts. Later, on November 23, 2017, the Code was amended to include Sec. 29A, effective as of the original date of enactment. The second amendment to the Code, modifying Sec. 29A, was signed into law on June 6, 2018.

The eligibility of Resolution Applicants in the Corporate Insolvency Resolution Process is regulated by Sec. 29A of the IBC, 2016. The Code's early draughts lacked provisions that would have barred defaulting promoters from repurchasing the corporate debtor at steep discounts. After the Code was last updated, on November 23, 2017, Sec. 29A was added to it for all time. A new amendment to the Code, Sec. 29A, went into effect on June 6, 2018, bringing with it some changes.

Ineligibility Under SEC. 29A:

In Sec. 29A of IBC a person is ineligible if:

- Person is an undischarged insolvent
- Person is a willful defaulter according to the guideline issued by RBI Banking Regulation Act 1949
- At least one year has elapsed since the RBI classified an account held by the individual as a non-performing asset, or an account of a corporate debtor over whom the individual exercises management, control, or promotion;
- To qualify to submit a resolution plan, a person must first pay any outstanding principal, interest, or fees related to non-performing asset accounts.
- The offender received a conviction for a felony that carries a mandatory minimum term of two years in prison;
- To be ineligible as a director under the Companies Act of 2013;
- The SEBI has issued a prohibition on the individual's participation in the securities markets;
- An individual who: • promoted or exercised management or control over a corporate debtor in which a preferential deal, an undervalued transaction, an extortionate credit transaction, or a fraudulent transaction occurred, and for which the Adjudicating Authority issued an order in accordance with this Code;

Any of the following actions constitutes compliance with this Code. Have a court-enforceable guarantee executed on behalf of a creditor of a corporate debtor whose bankruptcy resolution application was granted.

Three Levels Of Ineligibility:

- Persons who, either directly or indirectly and in accordance with a formal or informal agreement or understanding, cooperate for the acquisition of shares, the exercise of voting rights, or the exercise of control over a firm are said to be acting in concert.
- Anyone involved in the resolution application process or who will be involved in the resolution plan implementation for the corporate debtor is considered to be "Connected Persons."; or
- A holding company, affiliate, or connected party of a given entity.

Any member of the promoter's (defaulter's) immediate family; any partner in a partnership firm or trustee of a trust with which the promoter is associated; any private company of which the promoter is a director and owns more than 2% of the capital; any private company in which the promoter is an owner of more than 2% of the capital.

Insolvency Law Committee Report Review:

The Insolvency Law Committee, formed to provide counsel to the government on concerns identified by stakeholders after the IBC's implementation, submitted its findings in March 2018. Many amendments were proposed by the Committee, including ones that would expand the pool of potential resolution plan submitters. The Committee Recommendation is as follows:

- To further illustrate why the scope of this Sec. was judged excessive, consider the following: • The phrase "person acting in concert may be read to extend to linked people under clause" (j). Also, the definition of "applicant" from the SEBI SAST Regulations would be rather inclusive. Therefore, the words "person acting jointly or in concert" must be removed.
- In terms of NPAs, the Committee recognised that ARCs, AIFs, IVs, etc. may fit inside the 29A (definition of) an NPA. For legal reasons associated with their line of work, they may be disqualified. Therefore, it was recommended that there be an exception for "financial companies" from the application of the clause. Taking into account the possibility of acquiring NPAs as a consequence of past CIRPs, it was suggested that such NPAs be exempt from 29A for a period of three years after the date of acquisition (c).
- In the same phrase, only accounts that fall within the purview of the Banking Regulation Act of 1949 may be labelled nonperforming assets. The scope of this has to be widened to include nonperforming assets (NPA) accounts, as per earlier instructions from an Indian banking sector regulator.
- Because Sec. 29A(d), which addresses criminal convictions, and Sec. 29A, which addresses disqualification from serving as a director, are of a more personal nature, they cannot be included in the definition of "connected persons" in clause (iii), which includes the holding company, the subsidiary company, the associate company, and related individuals.
- The requirement of a 2-year prison term for any conviction under 29A(d) was overly broad, as it could apply to infractions that have no effect on the company's ability to function. A schedule listing all applicable legislation, like the one in the Companies Act of 2013, could be included to limit the scope of the clause. In addition, a provision in the Representation of the People Act of 1951 mandates that the disqualification period be reduced from indefinite to six years. [4]
- The Committee also suggested adding an asterisk next to the same Sec. to clarify that the disqualification does not apply if a court stays an order. In addition, the Committee recommended that ineligibility would not apply in the case an appeal was taken against a disqualification under this provision or others, such as a willful defaulter, disqualification from Directorship, or restriction under SEBI. The Committee understood that this clause may be misused and abused.

- Individuals in positions of management or control shall not be barred from submitting proposals due to the activities of their predecessors, as stated by the Committee in Article 29A(g), which addresses preferential, extortionate, undervalued, or fraudulent transactions. A similar caveat to the one for NPAs should be inserted if a transaction happens in a firm acquired via CIRP and the action happened before the acquisition.
- The Committee took a stance on guarantors in accordance with NCLT's position in the RBL Bank case, finding that the purpose of the provision is not to exclude all guarantors merely because they have an enforceable guarantee. This is stated in 29A(h). Creditor invocation of the guarantee and subsequent failure to pay in whole or in part triggers disqualification under this sub-Sec. Therefore, "enforceable" must be taken out of the equation.
- Due to the all-encompassing nature of the disqualifications, it has been advised that the applicant provide an affidavit stating that they are not disqualified under any of the provisions of Sec. 29A. This affidavit will fulfil the criteria of Regulation 38(3) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016, thus that regulation may be removed. Due to the lengthy and intricate nature of Sec. 29A verification, it was also proposed that the 270-day timeframe for the Resolution be extended.
- It was suggested that certain changes be made to Sec. 30 (Submission of Resolution Plan) regarding the application of revisions to 29A so as not to impede CIRPs that are already well along in the process (which was the case in the RBL Bank case).

If a person has contributed to the corporate debtor's defaults, is unsuitable because of incapacities as indicated in the Sec., or is an "associated party" to another defaulting party, then that individual is barred from presenting a resolution plan under the Code. This provision provides reassurance to the company's creditors that they would be protected against dishonest people who, despite the company's earlier defaults, are still trying to benefit themselves by undermining the Code's overarching goals and do not want to contribute to the company's resurrection.

Due diligence under Sec. 29A must be done by the Resolution Professional. It is not sufficient for a prospective Resolution Applicant to supply an affidavit indicating that they are qualified to submit a resolution plan under Sec. 29A. To determine eligibility, if any, full due diligence on the prospective Resolution Applicants and its related parties must be performed out rapidly and within the appropriate time frame. If needed for carrying out the due diligence, the Resolution Professional should engage the potential Resolution Applicants for clarifications or additional information or documents. When adopting or rejecting a resolution plan, the CoC should carefully analyse the due diligence report that the resolution expert produced, which lists the people who are ineligible to petition for a resolution. The entirety of Sec. 29A sets constraints not only on the promoters but also on everyone associated to or affiliated to the promoters.

The purpose of implementing Sec. 29A is simply to restrict those people from submitting a resolution plan who may negatively influence the entire corporate bankruptcy resolution process. The IBC timescales, which were otherwise being hampered by the exploitation of the bid process's vulnerabilities, would also be more easily adhered to as a result of this.

The concerns raised about the application and scope of Sec. 29A have been answered in the Jaypee Infratech Case/Homebuyers Case. The Supreme Court made this comment while analysing the eligibility of Jaiprakash Associates Limited ('JAL'), the parent company of Jaypee Infratech Limited, as a resolution applicant under Sec. 29A. JAL and other promoters are not entitled to submit a resolution plan as they are ineligible and fall under the jurisdiction of Sec. 29A. It has determined that strict adherence to Sec. 29A is required and that intentional defaulters shall not be entitled to participate in the corporate bankruptcy resolution process. It has termed the insertion of Sec. 29A a "plugging loophole".

In order to prevent the entry of frivolous applicants, it provides a diligence framework that enables the committee of creditors to properly assess the solvency, integrity, and credibility of a resolution applicant before approving a resolution plan, keeping in mind the scale, complexity, viability, and feasibility of a resolution plan. Additionally, it strives to guard against impurity or intoxication, which were recently observed in the Synergies Dooray case, in which the corporate debtor business amalgamated with a related party while Edelweiss ARC, the lender, received a roughly 95% haircut on its recovery. The consequences for infringing the Code are stated down in the Ordinance, which will ultimately help to prohibit frivolous applicants from participating in the resolution process.

If the applicant covers all of its obligations, as required by the clause, it will also be allowed to file as a resolution applicant under Sec. 29A in conformity with the judgments of the Supreme Court. The related party clause precluded ArcelorMittal and Numetal from making proposals for Essar Steel. For Numetal, the beneficiary was Rewant Ruia, the son of Essar Steel promoter Ravi Ruia, while ArcelorMittal controlled 29.05% of defaulter Uttam Galva. ArcelorMittal's bid for Essar Steel was authorised after the business cleared the remaining debt due by Uttam Galva (approximately Rs 7,000 crore) (around Rs 7,000 crore).

The promoters of Essar Steel provided the lenders with a settlement offer that was around 25% greater than the H1 bidder's. Sec. 29A of the IBC makes it unlawful for the promoters to submit a rival proposal. According to Sec. 12A, newly established law, Essar Steel's supporters have requested for the CIRP to be terminated. Lenders of Essar Steel elected to carry ahead with the H1 bidder rather than accept the promoters' offer to terminate the CIRP process in conformity with Sec. 12A of the IBC.

Although the addition of Sec. 29A filled some legal gaps in the Code, it also added complexity to the insolvency resolution process by charging the resolution professional or liquidator with the responsibility of determining whether or not resolution applicants were qualified, thus delaying the conclusion of the corporate insolvency resolution process.

The Ordinance's high qualification conditions preclude the great majority of local and international bidders from taking part in the bidding process. It may lower the value of any settlement mechanism even further.

The term "related party" in reference to a person covers a broad variety of individuals who are thus disqualified. In addition, when determining whether or not a person is "related" under Sec. 29A, that person's spouse's family members will now be included in the calculation.

Financial companies are not included in the Code's definition of "associated party." It also provides limited exemptions to the micro, small, and medium sector enterprises (referred to as "MSMEs") from the application of Sec. 29A and permits its promoters to submit a resolution plan as long as he is not a willful defaulter, in light of concerns regarding third party interest in submitting a resolution plan for the MSMEs[i].

The bankruptcy proceedings involving Ruchi Soya Industries Ltd. are an excellent illustration of the vast array of ineligibility grounds that may be utilised by rival bidders to contest the resolution applicants' eligibility. Adani Wilmar was picked as the best proposal by the committee of creditors, and a resolution plan is currently being created. Meanwhile, the runner-up bidder Patanjali Ayurveda filed an ineligibility challenge against Adani Wilmar under Section 29A of the Code. Weirdly, Adani Wilmar is supposed to be disqualified as the spouse of the company's managing director is a promoter who is in arrears on payments. Patanjali Ayurveda has lodged with the National Company Law Tribunal (NCLT) to contest the committee of creditors' decision to accept Adani Wilmar's bid. Individuals who have significantly contributed to the defaults of the corporate debtor, are undesirable due to incapacities as described in this section, or are an "associated party" to another defaulting party are excluded from offering a resolution plan under the Code. This provision provides reassurance to the company's creditors that they will be protected against dishonest people who, notwithstanding the company's earlier defaults, attempt to benefit themselves by undermining the Code's overarching goals and do not want to contribute to the debtor's resurrection.

In this instance, the lenders are ready to accept payments from the promoters that are greater than the highest offer. Therefore, the lenders would be better off adopting the promoters' offer rather than the highest offer. Section 29A's limits indicate that the lenders can't utilise the promoters' higher price. The politicians have a delicate line to travel between preserving the interests of creditors and making them worse off. In order to establish who is giving the biggest price and delivering the best returns to the creditors, and to prevent unscrupulous promoters from regaining control of the corporate debtor and its assets, any changes must have rigorous qualifying conditions.

In the case of the defunct Monnet Ispat, for instance, the related party clause produced major confusion. They only got offers from AION Capital and the JSW consortia consortium. The founder of Monnet Ispat, Sandeep Jajodia, is connected to the JSW Steel founder, Sajjan Jindal, via marriage. Lenders sought legal assistance before electing to continue with the acquisition. The clause enraged Sajjan Jindal, who said it was an immature condition that precluded the top bidder from resurrecting the business and delivering the biggest return for whatever reason.

If creditors are receiving what they need from the resolution plan and it otherwise meets all standards, then why should it be reevaluated?

The basic purpose of the legislation is to revitalize the company and avoid liquidation, however this section does not achieve either of those goals since it disqualifies the majority of competent applicants for resolution.

Conclusion:

The onerous disqualification standards set by Section 29A will prevent petitioners from making valid resolutions. Important stakeholders may be discouraged from making a bid for the company's revival if the provision is applied. When deciding situations of disqualification, the courts must exercise some mercy in order to fully implement the Code's objectives. The existing restriction may be replaced with a compromise that permits promoters to make bids for the corporate debtor while ensuring that enough safeguards are in place to ensure that the lenders benefit the most from the resolution process.

By striking a balance that discourages promoters from becoming resolution applicants while still providing the necessary safeguards (such as those mentioned above) to protect the other stakeholders, the IBC and CIRP processes may become much more economically viable for the promoters and the lenders.

In addition, there has to be some wiggle room in related party transactions so that promoters of ethical businesses aren't pressured into paying unethically large payments to their financiers.

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