SECTION 29A: A wide net of ineligibities for being a Resolution Applicant

Aditi Kashyap
Senior Associate

The insolvency regime in India is still in its nascent stage and even after close to two (2) years since the Bankruptcy Law Reforms Committee submitted its report, which laid the foundation of the Insolvency and Bankruptcy Code, 2016 (the "**Code**"), it can be said that it is still a "work in progress". One of the most prominent features of the Code has been the process of inviting a resolution plan, which did not find a place in the earlier regime i.e. winding up under the Companies Act.

A resolution plan is a solution oriented step carved out in the Code for revival of the insolvent entities and is designated to be the "way-out" for such insolvent entities. The resolution professional appointed by the adjudicating authority/National Company Law Tribunal (the "**NCLT**") constitutes a committee of creditors, invites resolution plans from prospective resolution applicants, and places the resolution plans before the committee of creditors. The resolution plan which is approved by the committee of creditors is submitted to the NCLT for approval. The resolution plan is submitted by a resolution applicant, who as originally defined under Section 5(25) of the Code is any person who submits a resolution plan to the resolution professional basis the information memorandum prepared by the resolution professional. Such resolution plan is approved by the NCLT subject to the compliance of certain conditions as laid down in Section 30 of the Code. As such, a resolution applicant could have been any person - a creditor, a promoter, a guarantor, a prospective investor, an employee, or any other person. The Code before being amended did not provide for any eligibility criteria for selection of the resolution applicant. This posed a huge risk in relation to allowing defaulting promoters to buy-back the assets of the corporate debtor at a discounted price, which led to the promulgation of the provision providing for the persons not eligible to be a resolution applicant vide the Insolvency and Bankruptcy Ordinance, 2017 (the "**IBC Ordinance 2017**").

Subsequently, on January 18, 2018, the aforementioned Ordinance took the shape of Insolvency and Bankruptcy Amendment Act, 2017 (the "**IBC Amendment Act**"). Section 1 (2) of the IBC Amendment Act clarified that the said amended Act would come into force on November 23, 2017. The said provision has been introduced to bar certain persons and entities from being a resolution applicant. Post the amendment, the definition of resolution applicant under section 5(25) of the Code now reads as under:

"*resolution applicant" means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25".*

It is pertinent to note that prior to the IBC Amendment Act, section 25 of the Code, sub-section (2), clause (h) stood as set out below:-

"(h) invite prospective lenders, investors, any other persons to put forward resolution plans"

The IBC Amendment Act brought an amendment in section 25 of the Code, sub-section (2), clause (h), as set out below:-

"(h) invite prospective resolution applicants, who fulfil such criteria as may be laid down by him with the approval of committee of creditors, having regard to the complexity and scale of operations of the business of the corporate debtor and such other conditions as may be specified by the Board, to submit a resolution plan or plans."

In view of the aforesaid amendment, only those resolution applicants could be invited by the resolution professional that fulfil the criteria laid down by him in consultation with the approval of committee of creditors as stated above. As such, the IBC Amendment Act imposes certain conditions on a person who could be invited to be a resolution applicant by the resolution professional for the purposes of submission of the resolution plan.

Further, Section 29A introduced by the IBC Amendment Act provides that a person would not be eligible to submit a resolution plan, if such person fell under any of the parameters as set out herein below:-

a) is an undischarged insolvent;

b) is a wilful defaulter in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949;

c) 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 the guidelines of the Reserve Bank of India 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 resolution plan;

d) has been convicted for any offence punishable with imprisonment for two years or more;

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

f) prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;

g) 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 in respect of which an order has been made by the Adjudicating Authority under this Code;

h) 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 this Code;

i) has been subject to any disability, corresponding to clauses (*a*) to (*h*), under any law in a jurisdiction outside India; or

j) has a connected person not eligible under clauses (*a*) to (*i*).

For the purposes of the above provision, a "connected person" is a person who is a promoter or in the management or control of the resolution applicant; a person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; a holding company, subsidiary company, associate company or related party of a promoter or a proposed promoter during the implementation of the resolution plan.

In view of the above provision, it can be seen that the aforesaid ineligibility of a resolution applicant exists in the following categories:-

(i) where the person itself is ineligible;

(ii) where a "connected person" is ineligible;

(iii) being a "related party" of connected persons who are ineligible;

(iv) where a person acting jointly/in concert with a person who falls under points (i), (ii) and (iii) above, is ineligible.

In view of the above, a resolution applicant has to be:

(i) the one who fulfils such criteria as laid down by the resolution professional with the approval of committee of creditors as set out above and such person or any other person acting jointly or in concert with such person; and

(ii) must not fall under the categories enlisted under Section 29A of the Code, as set out above.

It is pertinent to note that amongst the parameters as set out above, clause (h) has been most frequently deliberated, as it has been seen that in several cases, the Debtor's performance/obligation was guaranteed by a corporate/personal guarantor under a Deed of Guaranty.

In this regard, the NCLT, Kolkata Bench, in ***RBL Bank Limited vs. MBL Infrastructures Limited****, decided on December 18, 2017* whilst interpreting clause (h) of Section 29A of the Code, has observed that the object of clause (h) of section 29A is not to disqualify the promoters as a class for submitting a resolution plan. The intent is to exclude such guarantors from offering a resolution plan, who on account of their antecedents, may adversely impact the credibility of the process under the Code. The NCLT categorically held that "*Enforceable guarantee in context of clause (h) means and refers to such class of guarantors within the entire class of guarantors, who on account of their antecedents, may adversely impact the credibility of the processes under the IB Code. A contract of guarantee under which no claim has been made and which need not be performed cannot be treated as a subsisting or enforceable contract for clause (h) of section 29A, as the liability to pay for a guarantor arises when the debt is crystallized. If the guarantee is not invoked and demand is not made on the guarantor, debt payable by him is not crystallized. The guarantor cannot, therefore, be said to be in default for breach of guarantee and penalise merely because a legal and binding contract of guarantee exists which is enforceable but is subject to its invocation by the terms of guarantee"*.

Therefore, the NCLT clarified that there cannot be a blanket application of clause (h) and one has to consider whether the guaranty has been invoked and has the guarantor committed any default. If none of the aforementioned elements are present in a given case, it may well be the case that there will be no dis-qualification on the part of the guarantor.

Moreover, during the moratorium, personal guarantee could not be invoked. Therefore, the personal guarantor could not be barred from being a resolution application under Section 29A (h) of the Code.

Further, the NCLT, Mumbai has recently held that Section 29A of the Code is not applicable to the proceedings initiated prior to the date of the IBC Ordinance 2017, i.e. November 23, 2017.
The wide range of disqualifications of a resolution applicant under Section 29A of the Code seemed to be counter-productive as it could have resulted into a whole lot of intending resolution applicants being disentitled, in view of the widely worded definitions of related party, connected persons etc., intertwining all the entities promoted by an entity. In order to resolve the aforesaid lacuna created by Section 29A of the Code, on June 6, 2018, Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (the "**IBC Ordinance 2018**") has been promulgated, which brings certain material amendments in relation to Section 29A of the Code, *inter alia* as set out below:-

(i) Clause (c) is amended to the extent of the resolution applicant at the time of submission of resolution plan has an account classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 or the guidelines of a financial sector regulator issued under any other law for the time being in force;

(ii) Proviso to clause (c) to the extent that it shall not be applicable to an applicant which is a financial entity and is not a related party to the corporate debtor by inserting the meaning of "financial entity", who would not fall within the non-eligibility criteria on account of it being a "related party";

(iii) Explanation I to Proviso to clause (c) to the extent that the expression of "related party" will not include a financial entity regulated by the financial sector regulator, if it is a financial creditor of the corporate debtor and is a related party of the corporate debtor solely on account of conversion of debt into equity prior to the insolvency commencement date;

(iv) Explanation II to Proviso to clause (c) to the extent that where a resolution applicant has an account or an account of the corporate debtor under the control of such person or of whom such person is promoter, classified as non-performing asset and such account was acquired pursuant to a prior resolution plan, then the provisions of clause (c) shall not apply to a resolution applicant for three (3) years from the date of approval of resolution plan;

Clause (d) has been substituted to the extent, if the person has been convicted for any offence punishable with imprisonment for two years or more under any Act specified under the Twelfth Schedule or for seven years or more under any law for the time being in force. The said clause is not applicable to a person on the expiry of two years from the release from imprisonment. The said clause is not applicable to a connected person;

(i) Clause (e) has been amended to the extent that it is not applicable to a connected person;

(ii) A proviso to clause (g) has been inserted to the extent that such preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of the corporate debtor by the resolution applicant, and such resolution applicant has not otherwise contributed to such transactions;

(iii) Clause (h) has been amended to the extent that an enforceable guarantee is replaced with "a guarantee" and to the extent of inserting that "such guarantee has been invoked by the creditor and remains unpaid in full or in part";

(iv) The Explanation after clause (j) is numbered as Explanation I and is amended to the extent that such explanation is not applicable to an applicant which is a financial entity and not a related party to the corporate debtor;

(v) The further proviso to the Explanation I is inserted to the extent that the expression of "related party" will not include a financial entity regulated by the financial sector regulator, if it is a financial creditor of the corporate debtor and is a related party of the corporate debtor solely on account of conversion of debt into equity prior to the insolvency commencement date;

(vi) Explanation II inserted after Explanation I to the extent that the definition of financial entity has been inserted to meet certain criterion;

(vii) Insertion of Section 240A, which provides that clauses (c) and (h) of Section 29A of the Code would not apply to the resolution applicant in a corporate insolvency resolution process of any micro, small and medium enterprises.

Although Section 29A is well intentioned, it also brings with itself a wide net of ineligibilities for being a resolution applicant. Amendments to section 29A have been introduced to bring more clarity to eligibility criteria for submission of resolution plan. By inserting the meaning of "financial entity", who would not fall afoul of the eligibility criteria on account of it being a "related party" (proviso of Explanation I and newly inserted Explanation II after clause (j) in section 29A), will result in more participation by prospective resolution applicants in the resolution process. The intention of the Legislation by introducing Section 29A was to disqualify only those who had contributed to the downfall of the corporate debtor or were unsuitable to run/revive the company because of their antecedents whether directly or indirectly. However, extending the disqualification to a resolution applicant owing to infirmities in persons remotely related could have led to adverse consequences. Such interpretation of this provision would shrink the pool of resolution applicants. The very recent amendments introduced vide the IBC Ordinance 2018 definitely go to show that the restrictions on the eligibility of a resolution applicant under the original provision have been minimized in order to attract more participation by resolution applicants for timely and effective resolution process and revival of the judgment debtor. However, the implementation of the aforesaid amendments is yet to be seen in practise.

Our Offices

New Delhi
14th Floor, Dr. Gopal Das Bhawan
28, Barakhamba Road
New Delhi 110 001
T: +91 11 4213 0000
F: +91 11 4213 0099

Mumbai
1st Floor, Bajaj Bhawan
226, Nariman Point
Mumbai 400 021
T: +91 22 49100000
F: +91 22 49100099

E: info@clasislaw.com W: www.clasislaw.com