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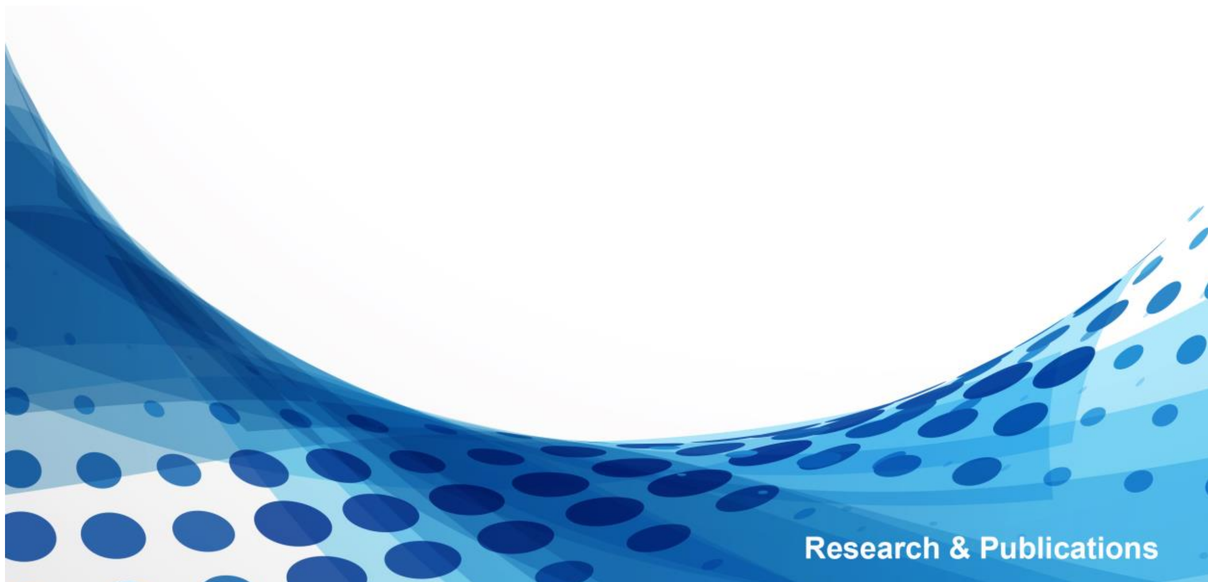

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Section 29A of India's Insolvency and Bankruptcy Code: An Instance of Hard Cases Making Bad Law?

M P Ram Mohan* & Vishakha Raj**

Abstract:

The Insolvency and Bankruptcy Code, 2016 (IBC) offers a mode of reorganisation for distressed corporations. The IBC's approach to corporate rescue limits the extent to which the incumbent management and promoters of a distressed corporation can participate in its rehabilitation. This is reflected in 29A of the IBC which, inter alia, excludes promoters and the incumbent management of corporations with non-performing asset accounts from submitting resolution plans. Though contained in the IBC, judicial interpretation has made section 29A applicable to corporate reorganisations under India's Companies Act, 2013 as well. The introduction and application of section 29A is reflective of a broader scepticism towards allowing promoters and directors to regain control of companies that went into financial distress under their watch. This paper re-evaluates section 29A by examining whether it has solved the problems it had set out to and finds that some ineligibilities prescribed for the incumbent management under section 29A need to be relaxed. It uses the example of the United Kingdom's insolvency regime (with which India bears similarities) to explain why resolution plans from promoters and the incumbent management should not be disallowed.

JEL classification code/s: K21, K10, K2, F23

Keywords: Section 29A, Insolvency and Bankruptcy Code, 2016, incumbent management, liquidation, corporate reorganisation, promoter.

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Introduction

Half a decade ago, India's insolvency law was recast with the intention to facilitate a distressed corporation's rehabilitation and maximise the value of its assets.[1] The law that provides for this is the Insolvency and Bankruptcy Code, 2016 (IBC).[2] To streamline the insolvency resolution process for corporations in India, the IBC borrowed from the United States' and United Kingdom's insolvency laws. These laws (that of the UK and the US) themselves have important differences in how they approach the insolvency resolution process. Once a company enters insolvency proceedings, the question of who ought to control the management of its affairs has been answered differently across the Atlantic. In the United Kingdom, the management of a company is taken over by an administrator once a company enters into the administration process.[3] Through this process, the creditors of a company vote on proposals that decide how the company is to be rescued.[4] During administration, the Board of Directors are effectively replaced by the administrator. By contrast, US' bankruptcy regime allows the incumbent management of the corporate debtor to remain at the helm of the company's affairs during bankruptcy proceedings.[5] Creditors' approval, however, is required for the bankruptcy court to confirm the resolution plan.[6] The US model is referred to as a debtor-in-possession model, and the UK's a creditors-in-possession model. An important feature of these two approaches to insolvency proceedings is that despite their differences, they take place within regimes that acknowledge the value of rescue and rehabilitation as an outcome of the insolvency process over liquidation.[7]

The IBC is currently a creditor-in-possession regime under which the insolvency resolution process is steered by the debtor's creditors with the help of an insolvency resolution professional.[8] This portion of the IBC resembles the administration process in the UK, with the

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[1] *Understanding the IBC: Key Jurisprudential and Practical Considerations,* INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, 11, https://www.ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf (last visited, Jun. 24, 2021) [hereinafter *IBC Handbook*]
[2] Insolvency and Bankruptcy Code, No. 31, Acts of Parliament, 2016 [hereinafter *IBC*].
[3] The Insolvency Act 1986 c. 45, Sch B1, ¶1 [hereinafter *UK Insolvency Act*].
[4] *Id.* ¶ 53.
[5] Title 11 U.S.C. § 1107 (2021) [hereinafter *US Bankruptcy Code*].
[6] *Id.* § 1129.
[7] *See* Gerard McCormack, *Control and Corporate Rescue: An Anglo-American Evaluation*, 56 The International and Comparative Law Quarterly, 515, 515 (2007).
[8] *See* IBC Handbook, *supra* note 1, at 14.

resolution professional being analogous to the administrator. The judiciary plays an important role in the insolvency resolution process under the IBC; the final order approving the creditors' decision to liquidate the company or approve a resolution plan has to be confirmed by the adjudicating authority.[9] The National Company Law Tribunal (NCLT) is the adjudicating authority designated by the IBC and has a role which is broadly similar to that of bankruptcy courts under the US Bankruptcy Code.[10] regime.[11]

A unique feature of the IBC that is absent from both the UK's and US' insolvency and bankruptcy regimes is the conditions prescribed by the IBC for proposers of insolvency resolution plans (resolution applicants).[12] Section 29A of the IBC contains a list of conditions that would disqualify a potential bidder from being a resolution applicant.[13] The UK manifests its scepticism of a distressed company's incumbent management by limiting its ability to run the company during administration.[14] The IBC, through section 29A, goes one step further and effectively prevents the incumbent management from participating in the future of the company all together.

When the IBC was first enacted in 2016 based on the recommendations of the Bankruptcy Law Reforms Committee Report,[15] there was no bar on who could propose a resolution plan.[16] About a year and a half after the IBC was enacted, section 29A was introduced through an amendment.[17] Though there are many prohibiting conditions under section 29A, this paper will focus on the ineligibility described under section 29A(c). Section 29A(c) makes ineligible anyone who is a promoter, director, or key managerial person of a company holding a non-performing asset account (NPA account) for over a year.[18] The effect of this provision is that promoters and the incumbent management of a company undergoing

[9] IBC § 31.
[10] Title 11 U.S.C. § 1107 (2021).
[11] *See* C. Scott Pryor, *Good News for Secureds in India*, 39 AMERICAN BANKRUPTCY INSTITUTE JOURNAL 26, 26–27 (2020).
[12] IBC § 5(25).
[13] IBC § 29A.
[14] McCormack, *supra* note 7, at 524.
[15] TK Viswanathan et al., The Report of the Bankruptcy Law Reforms Committee—
Volume I: Rationale and Design (2015) [hereinafter BLRC Report], https://ibbi.gov.in/BLRCReportVol1_04112015.pdf. [hereinafter BLRC Report].
[16] *See* Insolvency and Bankruptcy Code, No. 31, Acts of Parliament, 2016 as published on May 28, 2016, available at https://ibbi.gov.in//webadmin/pdf/legalframwork/2017/Jul/IBC%202016.pdf (last visited Jun. 24, 2021).
[17] The Insolvency and Bankruptcy Code (Amendment) Ordinance, No. 7, of 2017.
[18] IBC §29(c)

the insolvency resolution process are not allowed to bid for the rehabilitation of their own company. Of all the conditions under section 29A, clause (c) has been at the centre of discussions to relax ineligibilities for resolution applicants. In a recent report of a sub-committee that was tasked with devising a pre-packaged insolvency[19] framework for India, a few members (in the minority) had proposed that section 29A(c) be relaxed for pre-packaged insolvencies.[20]

The judiciary has played an important role in cementing the application of section 29A under the IBC. The first decision of the Supreme Court of India which related to section 29A held that the section warranted a purposive interpretation, and in doing so, used materials from Parliamentary Debates to explain the intention behind the provision. As will be discussed later, the reasoning of the judgement did not extensively rely on the legislative history of section 29A, rather, the Court used previous case laws relating to other legislation with similar phrases to interpret and apply section 29A. Notwithstanding the Court's actual reliance on purposive interpretation, the statement about the need to use purposive interpretation has had a palpable impact on judicial decisions. This paper scrutinises the motivations for enacting section 29A and focuses on how section 29A(c) in particular has influenced corporate restructuring in India. Here, we examine how the judiciary has expanded the application of section 29A through the use of purposive interpretation. Part I provides an overview of the IBC and the scope of section 29A within it. It also traces the origins of section 29A and explains why the ineligibilities under it are not nuanced enough to tackle the problem they were introduced to solve. Thereafter, Part II engages in a re-evaluation of section 29A(c) and makes a case for relaxing the provision.

I. The IBC and Section 29A: An Overview

At the outset, the IBC is geared towards facilitating the rescue and rehabilitation of a distressed corporation.[21] Liquidation is the last step provided for in the IBC once proceedings commence. Apart from the statutory order of these two processes under the IBC, courts at

[19] Pre-packaged insolvency refers to the process by which the creditors, corporate debtor and a purchaser agree on a resolution plan before insolvency proceedings formally commence. *See generally,* Ministry of Corporate Affairs, Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (Issued on October 31, 2020) (India), at 2 [hereinafter MCI Pre-pack Report].
[20] *Id.* at 50-51.
[21] IBC Handbook, *supra* note 1, at 14.

different levels of the judiciary have repeatedly pointed to the rehabilitative thrust of the IBC.[22] The rationale that underpins rehabilitative insolvency regimes (both in India and abroad) is the preservation of a corporation's surplus value.[23] This value comes from keeping the assets of the corporation together and continuing to run it as a going concern until a sale is made.[24] Importantly, surplus value is identified when the value of the corporation as a going concern exceeds the value of its assets when sold in a piecemeal basis.[25] Liquidation under the IBC is not restricted to piecemeal sales of a company's assets and allows for a company to be sold as a going concern.[26] Such a sale may be made through a scheme of arrangement or compromise under India's company law, the Companies Act, 2013.[27] In order to understand the full effects of section 29A on the IBC, a brief overview of its framework, along with relevant portions of India's Companies Act, 2013, has been discussed below.

The IBC provides for three modes through which the insolvency resolution process for a corporation can commence.[28] The first two require an operational creditor or financial creditor to file an application before the National Company Law Tribunal (NCLT), the adjudicating authority under the IBC. The difference between operational and financial creditors lies in the function of the transaction that resulted in the debt owed by the corporation. Transactions that have solely financial purposes (such as a bank extending a loan against interest) fall under the category of "financial debt" and those owed this debt are financial creditors.[29] Operational creditors' debts arise from transactions whose main purpose was not simply to extend credit. Where there is another underlying relationship with the corporation that gives rise to the debt, such as salaries due to employees or payments due to suppliers, the debt owed is known as operational debt.[30] Both operational and financial creditors can only file an application before the NCLT if the debt owed to the creditor exceeds INR 10,000,000.[31]

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[22] *See* Swiss Ribbons v. Union of India, (2019) 4 SCC 17, ¶ 27; Arun Kumar Jagatramka v. Jindal Steel and Power, 2021 SCC OnLine SC 220, ¶72.
[23] McCormack, *supra* note 7, at 517; H. Eidenmuller and K. van Zwieten, *Restructuring the European Business Enterprise: the European Commission's Recommendation on a New Approach to Business Failure and Insolvency* 16 EUROPEAN BUSINESS ORGANISATION LAW REVIEW 625, 655 (2015); Pratik Dutta, *Value Destruction and Wealth Transfer under the Insolvency and Bankruptcy Code, 2016*, National Institute of Public Finance and Policy, Working Paper No. 247, at 20 (2018).
[24] *Id.*
[25] *Id.*
[26] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Reg. 32.
[27] Companies Act § 230.
[28] IBC § 5(8)
[29] IBC § 5(21)
[30] *See* BLRC Report, *supra* note 15, at 77.
[31] IBC § 4.

Another crucial difference between operational and financial creditors is that the latter are at the helm of decision making during the corporate debtor's insolvency resolution process.[32] Financial creditors who are not related parties of the corporate debtor comprise the committee of creditors (CoC).[33] The CoC has the power to vote on insolvency resolution plans and may even vote to liquidate the corporate debtor.[34] These decisions of the CoC are taken with a minimum of 66 percent voting share (calculated based on the portion of the total debt owed to each financial creditor). If the CoC does not approve an insolvency resolution plan (which requires a 66 percent majority) within one hundred and eighty days, the NCLT will pass an order to liquidate the corporate debtor.[35] Operational creditors do not have the ability to vote unless the debtor has no financial creditors.[36] In exchange for limited participation in the insolvency resolution process, the IBC offers operational creditors certain protections. Operational creditors are guaranteed a minimum portion of plan distribution proceeds which equals the amount they would have received in the event of the company's liquidation.[37]

The third means by which a company can commence the insolvency resolution process is by filing an application under section 10 of the IBC.[38] In the event of a default, the corporate debtor may file an application before the NCLT, setting in motion the insolvency resolution process. Thereafter, the procedure is the same as in the case of the first two routes through which proceedings are commenced. An interim resolution professional is appointed and the CoC is formed.[39] The CoC appoints a resolution professional and then the process of inviting resolution plans for the CoC to consider and vote on begins.[40] It is at this stage that section 29A assumes relevance as it controls who may submit insolvency resolution plans with respect to a corporate debtor.

[32] IBC § 21.
[33] *Id.*
[34] *Id.* § 33(2).
[35] *Id.* § 33.
[36] *Id.* §21.
[37] *Id.*
[38] *Id.* § 10.
[39] *Id.* §§16, 21.
[40] *Id.* §§ 21, 22, 30.

A. Section 29A and the systematic exclusion of promoter participation

Several conditions that result in ineligibility have been enumerated under section 29A. Three of these are closely linked to the corporate insolvency resolution process in that they involve the non-payment of dues or defaults, which set in motion the IBC's machinery. These three conditions of ineligibility are fulfilled if one is either a wilful defaulter, an undischarged insolvent, has control over an account that has been declared an NPA for over a year, or if a person is a guarantor for a debtor against whom proceedings under the IBC have commenced.[41] Other conditions of ineligibility arise out of a person's conduct as decided by other spheres of commercial law. For instance, persons who have been prohibited from trading in the securities market by the Securities and Exchange Board of India, persons who have been disqualified as directors under the Companies Act or persons who have been convicted of an offense and imprisoned for a period exceeding two years or seven years (depending on the offense).[42] In addition to these ineligibilities, persons who have connected parties that are subject to ineligibilities under section 29A are also banned from proposing a resolution plan for a corporate debtor. Connected parties include past and present promoters of the resolution applicant, the incumbent management of the resolution applicant, or a holding or subsidiary company of the resolution applicant. This would mean that X, being a company, whose subsidiary has an NPA account, cannot file a resolution plan for Y, a company undergoing the insolvency resolution process.

In addition to influencing the insolvency resolution process, the ineligibilities under section 29A also decide the persons to whom a company's assets may be sold after a liquidation order is passed by the NCLT. The 2018 amendment[43] to the IBC that inserted section 29A also amended section 35 of the IBC which, *inter alia*, gives the liquidator the power to sell the corporate debtor's movable and immovable assets during liquidation.[44] After the amendment, the liquidator was prohibited from selling movable and immovable assets of the corporate debtor to any person who is not eligible to submit a resolution plan. Thus, section 29A is applicable to purchasers of the company's assets during liquidation. The IBC gives secured creditors the option to relinquish their security to the liquidation estate or realise its value

[41] *Id.* §§ 29(a), (b), (c), (h).
[42] *Id.* §§ 29(d), (e), (f).
[43] Insolvency and Bankruptcy Code (Amendment) Act, No. 8, Acts of Parliament, 2018.
[44] *Id.* § 7; IBC § 35.

outside the liquidation process of the IBC.[45] In the case of the former, the amended section 35 restricting the liquidators' powers to sell the corporate debtor's assets would apply. In the case of the latter, Liquidation Regulations[46] of the IBC operate to prohibit secured creditors from selling their assets to persons hit by section 29A of the IBC.

The scope of section 29A as understood from its bare text does not single out the promoters and the incumbent management of the corporate debtor.[47] Rather, section 29A contains general prohibitions applied to filter persons who may submit insolvency resolution plans. But some of the criteria under section 29A are almost always met by promoters or the incumbent management of the corporate debtor. For instance, the definition of an NPA refers to any loan whose payment is overdue for a period that exceeds 90 days.[48] If this classification exists for over a year, then the promoters and incumbent management of the company will become ineligible to file an insolvency resolution plan. In other words, only those promoters whose companies go into the insolvency resolution process within one year of having defaulted on their loans will be eligible to submit insolvency resolution plans. Apart from the operation of section 29A, the events that led to its insertion in the IBC and the objectives of the law that brought it into force reveal that the provision's main purpose is to restrict the promoters' and existing management's ability to regain control of their distressed company.

B. A brief history of section 29A

The introduction of section 29A in the IBC was prompted by cases with unsettling results after the IBC was introduced. Early cases showed that promoters were able to regain control of their companies while leaving creditors to take substantial haircuts for their claims.[49] One case that has been cited to emphasise this tendency is the *Synergies Dooray*[50] case.[51] In this case, a resolution plan for the Company Synergies Dooray Automative Ltd. (Synergies Dooray)

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[45] *Id.* §§ 52-53
[46] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Reg. 37(8).
[47] INJETI SRINIVAS, THE STORY BEHIND SECTION 29A OF IBC *in* INSOLVENCY AND BANKRUPTCY REGIME IN INDIA: A NARRATIVE 100 (2020).
[48] *Master Circular- Prudential Norms on Income recognition, Asset Classification and Provisioning pertaining to the Advances Portfolio*, Reserve Bank of India, DBOD No. BP.BC/ 20 /21.04.048 /2001-2002, ¶ 2.1.3.
[49] MCI Pre-pack Report, *supra* note 19, at 2; Veena Mani & Ishan Bakshi, *The Curious Case of Synergies Dooray and its implications of the insolvency code,* BUSINESS STANDARD (Sep. 20, 2017), http://www.business-standard.com.iima.remotexs.in/article/companies/flaws-in-the-insolvency-code-117091900999_1.html.
[50] Edelweiss Asset Reconstruction Company Ltd v. Synergies Dooray Automotive Ltd. & Ors., 2018 SCC OnLine NCLAT 845 [hereinafter Synergies Dooray].
[51] *See* SRINIVAS, *supra* note 47, at 98; MCI Pre-pack Report, *supra* note 19, at 2.

was filed by a related party of the company, namely, Synergies Castings Ltd. This plan, which provided for the repayment of about 5 percent of financial creditors' debts was approved by the CoC of the company (which comprises solely financial creditors). The NCLT confirmed this plan under section 31 of the IBC. One of the financial creditors of the CoC, Edelweiss Asset Reconstruction, holding 9.8 percent of the voting share in the CoC filed an appeal against the approval of Synergies Castings' plan.

The key contention of Edelweiss finance was that Synergies Castings had dubiously circumvented the prohibition of related parties of the corporate debtors being a part of the CoC during the insolvency resolution process. Section 21(3) of the IBC prevented related parties of the corporate debtor from being members of the CoC even if they were financial creditors.[52] Synergies Castings was admittedly a related party and could not participate in the CoC to vote on resolution plans.[53] However, before insolvency proceedings were initiated, Synergies Castings transferred over 90 percent of its claims to Millennium Finance Ltd. (another financial creditor of Synergies Dooray). This gave Millennium Finance Ltd. a 76 percent voting share in the CoC.[54] Edelweiss alleged that this was a backdoor used to negate the effects of the IBC's prohibition of related parties voting in the CoC.[55] The National Company Law Appellate Tribunal (NCLAT) found that the assignment of Synergies Castings' debt to Millennium Finance was done properly.[56] This being the case, nothing in the IBC prevented Millennium Finance from exercising its voting rights even though it had been acquired from a related party of the corporate debtor.[57]

The NCLAT's final order approving the resolution plan of Synergies Castings was passed in December 2018. Prior to this, the NCLT's final orders rejecting applications against the resolution plan were passed in August 2017.[58] These events gave rise to concerns about the integrity of the IBC's process and prompted suggestions such as amending the IBC's claw back provisions to apply to transfers or assignments of debts by related parties prior to the insolvency

[52] Synergies Dooray, *supra* note 52, ¶¶ 15,20.
[53] *Id.* ¶41.
[54] *Id.* ¶ 4.
[55] ¶¶ 15,20.
[56] *Id.* ¶¶ 71–72.
[57] *Id.*
[58] *Id.* ¶ 2.

resolution process.[59] Shortly after the NCLT's order in *Synergies Dooray* (August 2017), the IBC was amended in January 2018, inserting section 29A within the scheme of India's insolvency resolution framework.

There are two striking features of section 29A's origins, the first is the speed with which this amendment was conceptualised. Notably, the amendment came into force with effect from November 2017, this was about a year and a half after the IBC came into force. Secondly, while the *Synergies Dooray* case seems to have prompted the insertion of section 29A in the IBC, there may have been less invasive changes that could have been made to prevent history from repeating itself. For instance, stricter rules for the transfer of debts during the period prior to the insolvency filing could have been contemplated. Such norms exist under the IBC for undervalued transactions and transactions resulting in the preference towards one creditor over the other.[60]

The IBC recognises that before insolvency proceedings commence, the corporate debtor has the ability to dispose of their property to the detriment of the collective interests of creditors. Undervalued transactions refer to disposals of property without any consideration or for a consideration that is significantly lesser than the commercial value of the property.[61] The NCLT has the power to set aside undervalued transactions carried out up to one year before the commencement of insolvency.[62] If the undervalued transaction is with a related party, then the claw back period extends to two years.[63] Preferential transfers refer to transfers that are made to a creditor pursuant to an existing debt and have the effect of putting that creditor in a better position than other creditors.[64] The time period within which these transfers can be set aside are the same as undervalued transfers.[65] These avoidance provisions, however, only apply to disposals of property made by the corporate debtor. As mentioned above, one possible solution to prevent other cases like *Synergies Dooray* would be to bring transactions of related parties or parties that can be controlled by the corporate debtor within the purview of the IBC's avoidance provisions. At present, thought section 29A prevents promoters from regaining

[59] *See* Veena Mani & Ishan Bakshi, *The Curious Case of Synergies Dooray and its implications of the insolvency code,* BUSINESS STANDARD (Sep. 20, 2017), http://www.business-standard.com.iima.remotexs.in/article/companies/flaws-in-the-insolvency-code-117091900999_1.html.
[60] IBC §§ 43, 45.
[61] *Id.* § 45
[62] *Id.* § 46.
[63] *Id.*
[64] *Id.* § 43.
[65] *Id.* § 44.

control of their company, the issue of related parties being members of the CoC, which was the main concern in *Synergies Dooray* continues to persist. In order to address this, the Supreme Court seems to have used tools of purposive interpretation to limit the presence of voting shares in the CoC that were acquired as a result of transactions with a related party.

In the case of *Phoenix Arc Private Ltd. v. Spade Financial Services Ltd.*[66] the Supreme Court was dealing with creditors that were not related parties of the corporate debtor at the time of insolvency proceedings. However, these creditors were related parties at the time at which the transaction giving rise to their claims arose. The Supreme Court supported a purposive interpretation of the IBC and held that there may be instances in which related parties divest any interest they have in the corporate debtor in order to participate in the CoC. In such cases, these creditors ought to be excluded from the CoC. The Supreme Court acknowledged that a literal reading on the prohibition of related party participation in the CoC would not exclude such creditors who divest their interest in the company shortly before insolvency proceedings. However, the object and purpose of section 21(2) required these creditors to be excluded from the CoC.[67] The case of *Phoenix Arc* is not completely analogous to *Synergies Dooray*. But in both cases, related parties appeared to have negated the provisions of the IBC that kept them out of the CoC. In *Synergies* Dooray, though the resolution plan was submitted by a related party, the main allegation against the resolution plan was that it was approved by a CoC that was tainted by the claims of a related party. After *Synergies Dooray*, section 29A was enacted to help fix this problem but the focus was on controlling who can be a resolution applicant (section 29A) and not strengthening the provision excluding related parties from the CoC. Later, in *Phoenix Arc*, the Supreme Court had to take recourse to purposive interpretation (and not section 29A) in order to stop history from repeating itself.

The focus of the amendment that inserted section 29A did not address the root of the problem in *Synergies Dooray* – the participation of related parties in the CoC by assigning claims or divesting interests shortly before the insolvency resolution process commences. The most crucial amendment made by the 2018 Amendment was the introduction of section 29A whose overarching purpose was to limit promoter participation in a corporate debtor's rehabilitation. Remarks made in Parliament with respect to the amendment when it was a Bill

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[66] Civil Appeal No. 2842 of 2020 (Supreme Court)
[67] *Id.* at ¶94.

and the statement of objects and reasons of the Bill also help understand this overarching purpose. The statement of objects and reasons of the Insolvency and Bankruptcy Code (Amendment) Bill, 2017[68] (Amendment Bill) expressed concern about leaving a distressed company to persons whose misconduct contributed to the company's financial distress. Statements made in Parliament also refer to "unscrupulous promoters" taking advantage of the IBC to regain control of companies that they have mismanaged.[69] Portions of these statements have been referred to in judgements applying section 29A as well. These cases, along with the NCLT's contribution to expanding the scope of section 29A have been discussed below.

C. Judicial treatment of section 29A – a preference for purposive interpretation

The judiciary plays an important role under the IBC in that it confirms resolution plans on which the CoC has voted. The NCLT also passes the liquidation order that allows the sale of a company's assets through different means – sale on a piecemeal basis, as a going concern, or a sale through a compromise or a scheme of arrangement under the Companies Act, 2013. Appeals from NCLT orders lie with the NCLAT and appeals from the NCLAT in turn lie with the Supreme Court of India.[70] The NCLT, NCLAT, and Supreme Court have consistently upheld section 29A and applied it where required. In *Chitra Sharma,*[71] the Supreme Court had rejected the validity of a resolution plan that was agreeable to the financial creditors of the corporate debtor. The Supreme Court noted that the plan was hit by the resolution applicant's (promoter's) ineligibility under section 29A. While coming to this conclusion, the Supreme Court noted the purpose of section 29A and referred to the objects and reasons in the Amendment Bill – unscrupulous promoters were not to be rewarded that the expense of creditors.[72] *Swiss Ribbons*, is another important case in the development of the IBC's jurisdiction. This case dealt with challenges to the constitutional validity of several provisions of the IBC. One of these provisions was section 29A, and in particular, clause (c) which contains the prohibition against promoters of companies with NPA accounts for over a year. It was argued that section 29A(c) conflates malfeasance with defaults and by doing so, clubs together two different categories of promoters when evaluating resolution applicants.[73] The

[68] Bill No. 280 of 2017, Lok Sabha, at 5.
[69] *See* Swiss Ribbons, ¶ 93.
[70] IBC §§ 61-62
[71] Chitra Sharma v. Union of India, (2018) 18 SCC 575 (India), ¶¶ 36–37.
[72] 2018 SCC OnLine SC 874, ¶ 38.
[73] *Id.* ¶ 99.

Supreme Court in *Swiss Ribbons* was unpersuaded by this argument. The court noted that the gap of one year, in addition to the 90-day period after a default that needs to elapse before an asset is classified as an NPA, gives sufficient time to any resolution applicant to pay off their dues before proposing a resolution plan.[74]

The Court also noted that promoters have no vested right to submit an insolvency resolution plan, thus finding no infirmity with section 29A and declaring it as constitutionally valid.[75] The ineligibilities under section 29A essentially pierce the corporate veil and are extensive.[76] The opening lines of the section allow for a broad application of prohibitions by making their scope extend to persons acting in concert or jointly with those who are directly ineligible under section 29A.[77] Despite the broad ambit of section 29A, the Supreme Court has found it necessary to use purposive interpretation in order to apply the section.

i. Purposive interpretation and section 29A

The first judicial pronouncement that authoritatively explained the application of section 29A was made in the case of *Arcelormittal India Pvt. Ltd. v. Satish Kumar Gupta.*[78] The case of *Arcelormittal* (decided by the Supreme Court) was referred to in *Swiss Ribbons* to highlight the need to use purposive interpretation when applying section 29A.[79] In *Arcelormittal*, the NCLT and NCLAT had rejected two resolution plans for a corporate debtor (Essar Steel Ltd.) from two different resolution applicants on the grounds that they were ineligible under section 29A. One of the resolution applicants, Acelormittal India, was ineligible on account of one of its connected parties (Arcelormittal Netherlands) being a promoter of a corporation (not being Essar Steel Ltd.) that held an NPA account. The other resolution applicant was ineligible because its shareholders were promoters of the corporate debtor which also held an NPA account. One might argue that a plain reading of section 29A would be adequate to exclude the two resolution applicants described above. For instance, through the application of provisions under section 29A referring to parties acting in concert and its exclusion of connected parties of persons who are ineligible under the main provisions of section 29A. However, the

[74] *Id.* ¶¶ 103, 105
[75] *Id.* ¶ 102.
[76] *Id.*
[77] *Id.*
[78] Arcellormittal (India) Ltd. v. Satish Kumar Gupta, 2019 2 SCC 1, ¶116.
[79] Swiss Ribbons, ¶ 95.

Arcelormittal referred to the legislative history of section 29A and held that it needs to be considered while applying the provision. This trend of purposive interpretation under section 29A has allowed the judiciary to expand its application to processes that are not strictly within the purview of the IBC.

ii. *Section 29A and Schemes of Arrangement under India's Company Law*

Previous discussions have briefly touched upon the connection between the Companies Act, 2013 and the IBC in the context of liquidation – one of the means by which a corporate debtor can be liquidated is through its sale as a going concern and this can be achieved through a scheme of arrangement or compromise under the Companies Act.[80] A scheme of arrangement is entered into between a company and its members whereas a scheme of compromise is entered into between the company and its creditors.[81] These two tools under the Companies Act are means of corporate reorganisation and require the approval of three-fourths of the members or creditors of the company as the case may be.[82] The NCLT needs to approve arrangements and compromises so that they become binding.[83] Before January 2020, no explicit reference was made to arrangements and compromises under the Companies Act in the IBC nor its Liquidation Regulations. The implication was that these tools under the Companies Act could be used as method to sell a corporate debtor's assets during liquidation. The lack of any provision recognising arrangements or compromises within the framework of the IBC meant that the Companies Act governed these methods of corporate reorganisation; thus allowing even those promoters ineligible under section 29A to propose schemes under the Companies Act.

This position was reflected in discussion papers of the Insolvency and Bankruptcy Board of India (IBBI).[84] Though these discussion papers are not binding on courts, they are important sources for understanding the operation of the IBC's provisions. In a discussion paper circulated in April 2019,[85] the IBBI noted that IBC provisions that barred persons who were

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[80] Companies Act § 230
[81] *Id.*
[82] *Id.*
[83] *Id.* § 230-231.
[84] IBBI, Discussion Paper on Corporate Liquidation Process along with Draft Regulations, Apr. 27, 2019, https://ibbi.gov.in/Discussion%20paper%20LIQUIDATION.pdf [hereinafter *April Discussion Paper*]; IBBI, Discussion Paper on Corporate Liquidation Process along with Draft Regulations, Nov. 3, 2019 [hereinafter November Discussion Paper], https://ibbi.gov.in/uploads/public_comments/discussion_paper.pdf.
[85] April Discussion Paper, *supra* note 84, ¶3.3.3.

ineligible under section 29A from purchasing movable and immovable property of the corporate debtor did not apply to arrangements and compromises under the Companies Act.[86] The discussion paper also pointed out that it would be impractical to apply section 29A prohibitions to the Companies Act which is a broader legislation that is also applicable outside the context of liquidation.[87] In a subsequent discussion paper in November 2019,[88] the IBBI sought stakeholder comments on the issue of whether section 29A should be applied to compromises and agreements under the Companies Act. A total of 108 comments were received from stakeholders. [89]

An overwhelming majority of the comments, 108, were against the application of section 29A to arrangements and compromises under the Companies Act. [90] Only 3 comments were in favour of extending the ineligibility of section 29A to reorganisations under the Companies Act that were a result of IBC liquidation.[91] The key reasoning of those against the proposal was that the reorganisation under the Companies Act after liquidation was the last resort for a distressed company's revival and no restrictions should be imposed at this stage. This, according to a majority of the stakeholders, would also help realise the objectives of the IBC which was protecting the surplus value of the company and preventing its piecemeal liquidation.[92] The IBBI however, expressed its agreement with the minority which was of the view that arrangements and compromises under the Companies Act were a backdoor for promoters to regain control of their distressed corporations by by-passing section 29A.[93] The IBBI reiterated its concern about wilful defaulters and unscrupulous promoters regaining control of their corporations at the expense of creditors.[94]

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[86] *Id.*
[87] *Id.*
[88] November Discussion Paper, *supra* note 84.
[89] *Stakeholder Comments*, IBBI, at 5-6, https://ibbi.gov.in//webadmin/pdf/legalframwork/2018/Oct/PDF%20copy%20%20upto%2022.10.2018%20(Liquidation%20Process)%20Regulations_2018-10-26%2011:55:52.pdf (last visited July 2, 2021).
[90] *Id.*
[91] *Id.*
[92] *Id.*
[93] *Id.*
[94] *Id.*

D. Legislative Changes Following the Judicial Expansion of Section 29A

The discussion papers of the IBBI were circulated at a time when section 29A did not operate as a bar to compromises and arrangements under the Companies Act. Though the law at the time did not impose such a prohibition, the NCLAT, through purposive interpretation, effectively extended the scope of section 29A to the Companies Act. In *Jindal Steel & Power Ltd v. Arun Kumar Jagatramka*[95] the NCLAT was dealing with an appeal against the order of the NCLT which allowed the promoter of the corporate debtor to enter into a financial scheme of compromise and arrangement under the Companies Act. The appeal was filed by an unsecured creditor of the corporate debtor and required the NCLAT to decide on two issues. The first was whether a scheme of compromise or arrangement could be entered into during liquidation proceedings under the IBC. The second was the issue of whether the prohibition of section 29A would apply to such schemes.

On the first issue, the NCLAT referred to its own precedent and held that there was nothing under the IBC or its regulations that prevented schemes or compromises at the stage of liquidation.[96] Further, this would be in line with the IBC's objectives of reviving the corporate debtor. On the second issue, the NCLAT turned to section 35(1)(f) of the IBC. This provision prevents the liquidator from selling the corporate debtor's assets to persons who are not eligible to be resolution applicants (referring to section 29A). It may be noted here that in the discussion papers,[97] section 35(1)(f) was not considered to be a bar on compromises and arrangements which were governed by the Companies Act. As mentioned earlier, IBBI discussion papers are not binding, but a plain reading of the IBC's provisions (as they were in force in 2019) also supports the view that section 29A was not meant to apply to compromises and arrangements. The NCLAT, however, used section 35(1)(f) to conclude that the during liquidation, the corporate debtor would still need to be "*saved from its own management…*"[98] Thus, section 29A would apply to arrangements and compromises under the Companies Act.

The NCLAT's purposive interpretation of section 29A in *Jindal Steel Power* was influenced by the Supreme Court decision in *Swiss Ribbons*. The NCLAT quoted *Swiss*

[95] 2019 SCC Online NCLAT 759
[96] *Id.* ¶7.
[97] *See* April Discussion Paper, *supra* note 84, ¶3.3.3.
[98] *Id.* at ¶11.

Ribbons with approval when it held, *"As noticed above, the Hon'ble Supreme Court in Swiss Ribbons Pvt. Ltd. v. Union of India…held that the 'primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate death by liquidation.'"*[99] The decision in *Jindal Steel & Power* was received well by the IBBI and even informed its opinion when it proposed extending section 29A to reorganisation under the Companies Act.[100] The Liquidation Regulations were eventually amended in January 2020 to bar persons who were ineligible under section 29A from participating in arrangements and compromises with respect to corporate debtors undergoing liquidation.[101]

The decision of the NCLAT in *Jindal Power Steel* along with the January 2020 amendment were challenged before the Supreme Court of India.[102] The Supreme Court reviewed the IBBI discussion papers on the subject and the NCLAT's case law. Confirming the current trend, the Supreme Court held that a purposive interpretation of section 29A was warranted.[103] The January 2020 amendment was characterised by the Supreme Court as being of a clarificatory nature.[104] This seems to be at odds with the stance of the discussion papers of the IBBI which give the impression that section 29A of the IBC did not inherently impact the Companies Act However, through its decision in *Jindal Power* Steel, the Supreme Court has conclusively settled the question of whether the scope of section 29A applies to schemes of arrangements and compromises under the Companies Act.

A common theme across all decisions of the NCLAT and the Supreme Court is an underlying notion that the incumbent management and promoters of a corporate debtor should not be allowed to regain control of their company. This notion is based on the reasoning that those who have contributed to the downfall of the corporate debtor should not be allowed to play a continuing role in its future. The assumption that resonates through all of these decisions is that a corporate debtor's downfall is due to the actions of its management. Lawmakers also hold this view, as is shown by the statement of objects and reasons of the section 29A Amendment Bill which noted, "*Concerns have been raised that persons who, with their*

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[99] *Id.* at ¶10.
[100] Stakeholder Comments, *supra* note 89.
[101] *See* Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Reg. 2B.
[102] Arun Kumar Jagatramka v. Jindal Power & Steel Ltd., 2020 SCC OnLine 220.
[103] *Id.* ¶ 43.
[104] *Id.* ¶ 93.

misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process…"[105] Granted that in case the ineligibility applicable refers to having control over an NPA, the IBC requires reasonable time to be given to the resolution applicant so that they may pay their dues and no longer be in control of an NPA. However, financially distressed companies that are struggling with liquidity may not always be able to pay off outstanding dues. This means that the incumbent management and promoters of these companies will continue to the disqualified. In the context of the corporate debtor's own management or promoters, giving reasonable time to pay off dues contributing to an NPA is tantamount to requiring the corporate debtor to no longer be in a position that prompted it to come under the insolvency resolution process of the IBC. If the corporate debtor actually had the ability to repay its dues, it is unlikely that it or its creditors would have filed an application under the IBC on account of a default.

II. Re-evaluating Section 29A

The key thrust to the development of corporate structures which separated the liability of a company's owners and managers from the corporate entity came from a recognition that business involves some degree of risk, and that there exist benefits to incentivising these risks within the checks and balances offered by the framework of corporate governance.[106] The Bankruptcy Law Review Committee Report (BLRC Report) recognised the promotion of risk taking as an important feature of the limited liability corporation.[107] Though not formally expressed in these terms, insolvency law recognised the need to limit a trader's liability in case of commercial failure.[108] This is why insolvency law has been referred to as a surrogate form of limited liability.[109] Keeping in line with the commercial utility of insolvency regulation, traders were the first debtors that could be discharged under bankruptcy law.[110]

[105]Bill No. 280 of 2017, Lok Sabha, at 5. https://www.prsindia.org/sites/default/files/bill_files/Insolvency%20and%20Bankruptcy%20Code%20Amendment%20Bill%202017.pdf.
[106] McCormack, *supra* note 7, at 524; BLRC Report, *supra* note 15, at 23.
[107] BLRC Report, *supra* note 15, at 23.
[108] VENESSA FINCH, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 11 (2d ed. 2009)
[109] *Id.*
[110] *Id.*

In the context of insolvency, the control over deciding the future of a corporation shifts to its creditors from its shareholders. In some jurisdictions, this results in a change in management during the insolvency resolution process.[111] India follows the creditor-in-possession model through the IBC which bears important similarities with the administration process in the UK under the Insolvency Act, 1986.[112] Creditor-in-possession regimes are indicative of more scepticism towards the incumbent management than a debtor-in-possession regime.[113] This scepticism, however, need not translate into broad ineligibilities as enumerated under section 29A. The following discussion looks at the UK's administration process to understand how it has dealt with the potential abuse of the insolvency process by promoters and the incumbent management while retaining their ability to regain control of their companies.

A. Treatment of the incumbent management during insolvency in the UK

During the administration process, the management of company is replaced by an administrator (analogous to a resolution professional under the IBC). As a contrast to this, the US' debtor-in-possession model not only allows the debtor to continue to run its business during bankruptcy proceedings but is also given the exclusive right to propose a plan for a period of 120 days after a bankruptcy petition is filed.[114] Though the UK is sceptical of the corporate debtor's incumbent management and promoters, it does not go the extent of preventing them from participating in the company's rescue and eventually regaining control of their companies. Concerns about the incumbent management's participation in insolvency are heightened in the context of pre-packaged insolvency (pre-packs).[115] Pre-packs in the UK allow the assets of the corporate debtor to be sold by the administrator without the approval of a majority of its creditors.[116] Two evaluations of connected party sales (including sales to promoters and directors) during pre-packs have been carried out by the UK Government till date.

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[111] *See* McCormack, *supra* note 7.
[112] Insolvency Act 1986 c. 45, sch. B1.
[113] McCormack, *supra* note 7, at 524.
[114] Title 11 U.S.C. § 1121 (b).
[115] John M. Wood, *The Sun is Setting: Is It Time to Legislate Pre-packs?*, 67 Nr. Ir. Legal Quarterly 173, 176-177 (2016).
[116] *See* THE INSOLVENCY *SERVICE*, PRE-PACK SALES IN ADMINISTRATION REPORT (Oct. 8, 2020) (UK) [hereinafter PRE-PACK SALES REPORT], https://www.gov.uk/government/publications/pre-pack-sales-in-administration/pre-pack-sales-in-administration-report.

The first is the Graham Report of 2014.[117] This Report found that over two thirds of pre-packs involved sales to a connected party.[118] According to the Report, connected party pre-pack sales were more likely to disenfranchise unsecured creditors and had thrice the odds of failing when compared to a pre-pack sale to an unconnected party.[119] Despite these concerns surrounding connected party sales the Report did not recommend banning them. It was noted that in cases where the financial distress of the corporation is caused by industrial downturn, a corporate debtor may not attract bids from other entities within the industry.[120] In such cases, the corporate debtor's existing management or promoters may be the only ones willing to purchase the company as a going concern.[121]

More recently, the UK Government published another report on pre-pack sales.[122] Once again, the government noted the criticisms against connected party sales but did not recommend banning them.[123] Rather, the Pre-pack Sales Report recommended measures that would empower creditors and increase the transparency associated with connected party sales during pre-pack administration.[124] Pursuant to the Pre-pack Sales Report's recommendations, the UK Government published draft regulations on the subject which came into force in April 2021.[125] The Administration (Restriction on Disposals etc. to Connected Persons) Regulations, 2021[126] (Pre-pack Regulations) limit the administrator's ability to dispose of substantial portions of the corporate debtor's property within eight weeks of the day on which the company enters administration. The administrator can sell substantial portions of a debtor's property to a connected persons if the creditors approve of such sale or if the sale is accompanied by a "qualifying report".[127] The qualifying report needs to be obtained by the connected party and needs to be issued by a person who meets the requirements of an "evaluator" as described in

[117] TERESA GRAHAM, GRAHAM REVIEW INTO PRE-PACK ADMINISTRATION: REPORT TO THE RT HON VINCE CABLE MP 26 (June 2014) (UK) [hereinafter GRAHAM REPORT], https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration#:~:text=The%20report%20was%20carried%20out,Government%20response%20to%20the%20Review.
[118] *Id.* at 37.
[119] *Id.* at 51.
[120] *Id.* at 38.
[121] *Id.*
[122] PRE-PACK SALES REPORT, *supra* note 116.
[123] *Id.*
[124] *Id.*
[125] The Administration (Restriction on Disposals etc. to Connected Persons) Regulations 2021, UK Draft Statutory Instruments, ISBN 978-0-348-22042-1.
[126] *Id.* reg. 3.
[127] *Id.* reg. 5.

the Pre-pack Regulations.[128] The qualifying report is essentially a statement that speaks to whether the consideration of the sale is reasonable.[129] The UK's treatment of concerns surrounding connected party sales is an approach that is in stark contrast with India's. The UK's approach is also evidence that there exists a middle ground between giving a free rein to the incumbent management and promoters of a corporate debtor and imposing a virtual ban on their ability to participate in the revival of their company. The next section examines how India can relax portions of section 29A without compromising the integrity of the IBC.

B. Making a case for relaxing section 29A(c)

Of all the ineligibilities under section 29A, the clause regarding NPAs is one of the most difficult to justify. Other clauses under section 29A are easier to defend. For instance, there is no pressing reason to allow those who have been prohibited from trading in the securities market to submit resolution plans. The same applies to other categories such as persons who are undischarged insolvents or those who have committed crimes punishable with imprisonment. Section 29A(c) carries an ineligibility of a different character and has already been relaxed in the context of Micro, Small and Medium Enterprises (MSMEs).[130] A resolution applicant for an MSME will not be ineligible even if they are in control of an account or a company having an account that has been classified as an NPA for over a year.[131]

The ineligibility under section 29A(c) has no requirement of intentionality. A person holding an NPA account does not need to be a willful defaulter. According to the Reserve Bank of India (RBI), a willful default does not simply refer to the non-payment of dues.[132] For a default to be classified as a "willful default" it needs to be accompanied by the siphoning of funds for a purpose not sanctioned by the creditor, disposal of assets given as security to the creditor, or a default despite having the capacity to honor obligations towards the creditor.[133] In addition to these conditions, a default needs to be intentional and deliberate in order to be willful in nature.[134] Being a willful defaulter is a separate ineligibility under section 29A(b). As a contrast

[128] *Id.* regs. 6, 10.
[129] *Id.* reg. 7.
[130] IBC § 240.
[131] *Id.*
[132] Reserve Bank of India, Master Circular on Wilful Defaulters, DBR.No.CID.BC.22/20.16.003/2015-16, ¶ 2.1, https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9907#21.
[133] *Id.*
[134] *Id.*

to this, section 29A(c) is an ineligibility that can simply arise from not paying dues for one year and ninety days. In the context of modern insolvency law, this prohibition seems harsh since corporations that need the IBC the most are likely to have NPA accounts. One may argue that it is the management and promoters of the corporation and not its business that is denied a second chance by virtue of section 29A(c). While this is true, in cases where the promoters or the incumbent management are the only ones willing to submit a resolution plans for the corporation, the corporation will inevitably be liquidated because of a lack of eligible resolution applicants. For instance, in *Sunrise 14/AS Denmark v. Muskan Power Infrastructure*[135] the NCLT passed an order for the liquidation of the corporate debtor because the only resolution applicant was a member of the Board of Directors who was ineligible under section 29A.[136] This is not to say that the creditors would have approved the resolution plan proposed by the director in *Sunrise 14/AS Denmark*, but giving the CoC the opportunity to consider the resolution plan would not have detracted from the integrity of the IBC.

The IBC regime has enshrined within it robust protections for creditors. The most apparent one is creditors' ability to vote on resolution plans which are approved by a 66 percent majority. Financial creditors on the CoC also appoint the resolution professional who facilitates the insolvency resolution process. Significantly, and differing from the US and the UK, the IBC does not allow the resolution professional to dispose of over ten percent of the debtor's assets without the approval of the CoC.[137] The US allows such disposal under section 363(b)[138] of the US Bankruptcy Code and the UK empowers administrators with this power as well.[139] Though the Pre-pack Regulations of the UK restrict the administrators powers when the disposal involves sales to a connected party, no such restrictions apply to sales to unconnected parties. Even after the Pre-pack Regulations, sales to connected parties can be made in the absence of creditor approval if a qualifying report is produced.

Recently, India has considered rolling out its own pre-pack framework and has already amended the IBC to allow for MSMEs to pre-pack (discussed in detail later). The design of India's pre-pack framework as provided for in the recent Pre-packaged Insolvency Report[140]

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[135] 2018 SCC OnLine NCLT 4331.
[136] *Id.* ¶¶ 9, 15.
[137] Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016, Reg. 29.
[138] Title 11 U.S.C. § 363(b).
[139] Insolvency Act 1986 c. 45, Sch 1, at ¶2.
[140] MCI Pre-pack Report, *supra* note 19.

retains creditor voting rights. This means that 66 percent approval of financial creditors will be required even for a pre-packaged insolvency plan.[141] Whether in the context of a pre-pack or a regular insolvency resolution process, the CoC will thus continue to have the power to decide which resolution plan it approves even in the absence of section 29A(c). If no resolution plan is agreeable to the CoC, then the corporate debtor will have to go into liquidation under the IBC. There are thus adequate checks to ensure that the incumbent management is not able to arm twist the CoC to approve its resolution plan. These features of the IBC, however, have not been able to guarantee recovery for creditors. The average rate of return for creditors under the IBC has been 24 percent.[142] Even after the introduction of section 29A, there have been cases where creditors continue to take haircuts of over 90 percent of their debts.[143] Relaxing section 29A(c) may not have an effect on creditor recoveries, but it gives the CoC an additional resolution plan to consider. In cases where no external bidder is available, a promoter or incumbent management's plan can be the difference between rehabilitation and liquidation. The BLRC Report envisioned the CoC as the most important decision maker during the insolvency resolution process. A well informed CoC that is apprised of the antecedents of the resolution applicant should thus be trusted to root out unsustainable insolvency resolution plans.

C. Efforts made so far: Introspection and Inertia

The Bankruptcy Law Review Committee Report (BLRC Report) is a vital piece of literature when understanding the purpose of the IBC. This Report published by the Ministry of Finance contained the design of the IBC.[144] The interaction between the principle of limited liability and risk in the corporate structure and insolvency law was noted in the BLRC Report.[145] The report expressed support for allowing promoters to have a second chance at running their companies. Specifically, it was noted that the point of limited liability corporations is to foster some degree of risk taking. If a company has come into financial distressed on account of external factors and in the absence of any malfeasance or fraud on the part of the management, there is no reason why it should not be given another chance to succeed under the same

[141] *Id.* at 52.
[142] TT Ram Mohan, *Bankruptcy process needs a re-look,* THE BUSINESS STANDARD (July 8, 2021), http://www.business-standard.com.iima.remotexs.in/article/opinion/bankruptcy-process-needs-a-re-look-121070801514_1.html.
[143] *Id.*
[144] BLRC Report, *supra* note 15, at 30.
[145] *Id.* at 23.

management.[146] After the introduction of 29A(c) the IBC leaves little room for promoters to bid for their corporation in the event of it falling into financial distress due to market factors.

From the time of its inception, alternatives to section 29A have been floated by experts for the consideration of the IBBI. An account of the process that led up to the insertion of section 29A reveals that market-oriented alternatives were considered as in the place of section 29A.[147] For instance, one expert noted that measures such as the disclosure of the resolution applicants' antecedents and the CoC's freedom to reject plans that it perceived as below market value had the ability to check promoters' misuse of the IBC's process.[148] However, these measures would not cover all promoters.[149] But one may ask at this stage whether the issue lies with *all* promoters. Experts who played a role in drafting the law also recognized that the main causes for concern were a *few* unscrupulous promoters.[150]

The ineligibility under section 29A(c) thus seems to be more far reaching than the problem it was meant to solve. One means to reduce the scope of the section while catering to the rationale behind its insertion is to extend the time period for which persons can have control over NPA accounts before they are rendered ineligible. The current time period is one year after an account has been declared as an NPA. In 2018, the Ministry of Corporate Affairs published the Insolvency Law Committee Report[151] (ILC Report) which evaluated the working of the IBC and, *inter alia*, examined section 29A(c). The ILC report recommended that the time period under section 29A(c) be increased from one year to three years. The reasoning behind the three-year period before ineligibility takes effects was that downturns in a typical business cycle persist for periods beyond one year.[152] The ILC Report also noted that no concrete time period could be provided to guarantee that an NPA account existed because of a business downturn rather misconduct by the management. However, the ILC Report offers a solution, the effectiveness of which can be observed and the time period can be extended based on the types of resolution plans that occur after its implementation.

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[146] *Id.*
[147] SRINIVAS, *supra* note 47, at 98.
[148] *Id.*
[149] *Id.*
[150] *Id.*
[151] Ministry of Corporate Affairs, Insolvency Law Committee Report (2018)
[152] *Id.* ¶14.8

D. Section 29A and Pre-packaged insolvency

A more recent report that considered relaxing section 29A(c) was the IBBI's Report on Pre-packaged Insolvency (Pre-pack Report).[153] The impetus to remove the strictness of section 29A(c) ineligibility is closely linked to the design of India's pre-pack framework as proposed by the Pre-pack Report. Based on the Report, the pre-pack process is to be started by the corporate debtor.[154] In order to do so, the corporate debtor would need the approval of a simple majority of its shareholders and financial creditors. The pre-pack framework also retains a functioning Board of Directors during the pre-packaging process since the resolution professional is appointed only after negotiations with creditors are completed and a mutual understanding is reached.[155] The pre-packaging process thus shifts towards a debtor-in-possession model.[156] Even under the status quo, the corporate debtor has the ability to file an application before the NCLT and initiate the insolvency resolution process for itself (section 10). However, this mode of initiating the insolvency resolution process has not been preferred. Of all the insolvency proceedings initiated after the IBC's inception until June 2020, only 6.6 percent were commenced by the corporate debtor.[157] The Pre-pack Report identified three reasons for a company's reluctance to use section 10 of the IBC (initiation of insolvency by the distressed corporation).[158] The first of these reasons was that most incumbent managements are ineligible to submit resolution plans under section 29A(c) and know that they will most likely lose control of their companies after the insolvency resolution process is completed.[159] The other two reasons were that promoters may be worried about their plans being inferior to those received by external bidders, and the fear of having their company liquidated if the CoC does not approve a resolution plan.[160]

The second of the deterrents mentioned above will equally apply to the initiation of a pre-pack process if promoters are not allowed to submit a resolution plan. The pre-pack framework which is contingent on initiation by the corporate debtor may thus be underused if section 29(c)

[153] MCI Pre-pack Report, *supra* note 142.
[154] *Id.* at 37-38.
[155] *Id.*
[156] *Id.*
[157] *Id.*
[158] *Id.*
[159] *Id.*
[160] *Id.*

is not relaxed. The first reason identified by the Pre-pack Report for the current reluctance to use section 10 is important in understanding the power dynamic between the CoC and incumbent management under the regular insolvency resolution process. If the incumbent management is reluctant to commence insolvency proceedings for fear of being out competed by external bidders' plans, this suggests that irrespective of section 29A, the CoC will consider the better resolution plan. Evidently, the incumbent management is also aware of this.

E. Section 29A and MSMEs

The application of section 29A has already begun to cause some confusion in the context of pre-packs in India. Though a general pre-pack framework is yet to be rolled out. The IBC was amended in April 2021 to allow MSMEs to use pre-packs.[161] This was made possible through the insertion of Chapter III-A in the IBC. As discussed earlier, the IBC exempted resolution applicants for MSMEs from the scope of section 29A(c) even before pre-packs for MSMEs came into existence. This was achieved through an amendment to the IBC (section 240A) after section 29A was inserted.[162] When pre-packs for MSMEs were introduced in the IBC, section 240A was also amended to exempt resolution applicants for MSMEs with respect to the pre-pack process (in addition to the regular insolvency resolution process). Section 54A of the IBC, however, states that an MSME may initiate the pre-pack process only if it is not ineligible under section 29A.[163] This implies that in case an MSME has controlled over an NPA account for a period exceeding one year, it cannot file for pre-pack insolvency as it is ineligible under section 29A(c). One may argue that section 240A of the IBC would resolve this difficulty, but section 240A applies to resolution applicants. The condition of being eligible under section 29A is imposed on the corporate debtor under section 54A of the IBC. Thus, while section 240A would apply to resolution applicants, it may not apply to the corporate debtor. This leads to a strange outcome in which the resolution applicant is exempted from section 29A but the corporate debtor initiating pre-packaged insolvency is not. Some have attributed this situation to a drafting mistake by the IBC and others have stated that a harmonious reading of the pre-pack provisions with the rest of the IBC (section 240A) will continue exempt the corporate debtor from section 29A(c).[164]

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[161] Insolvency and Bankruptcy Code (Amendment) Ordinance, No. 3 of 2021.
[162] *Id.* § 8.
[163] IBC § 54A.
[164] *See* Ajay Kumar, *Pre Packaged Insolvency Resolution Process: Section 29A(c) and (h) Exemption For Resolution Applicant Or MSME Debtor?*, MONDAQ (May 6, 2021),

Existing case law on the subject confirms that a promoter of a corporate debtor under the normal insolvency resolution process can submit a resolution plan for their own MSME company. In *Shakambari Overseas Trades v. Darjeeling Rolling Mills*,[165] an operational creditor filed an application against an MSME company for the non-payment of operational debts. A resolution plan was jointly submitted by two persons, one of whom was promoter and director of the corporate debtor. This plan was approved by the CoC and allowed by the NCLT on account of section 240A which exempted the promoter/director from section 29A(c).[166] This case confirms that promoters can submit resolution plans for their own MSME companies even if they are otherwise ineligible under section 29A(c). However, this is only a partial resolution of the confusion arising from the wording of section 54A which imposes a restriction on who can initiate the insolvency resolution process. In *Shakambari*, the NCLT did not have to determine this question as the process was initiated by an operational creditor. Pre-pack proceedings under Chapter III-A, in contrast, will have to be initiated by the corporate debtor. The implications of section 54A and the extent to which section 240A can militate against their effect will become clear only after the NCLT begins to adjudicate cases on the issue.

The advisability of section 29A has been subject to robust debate since its inception. The decision to introduce a pre-pack framework in India has reemphasized the need to evaluate how the IBC treats the management of corporate debtors who have defaulted. The possibility of financial distress arising out of factors that are not attributable to the incumbent management's misconduct warrants a more nuanced skepticism of these stakeholders of the insolvency resolution process. Section 29A introduced important qualifications for resolution applicants and rightfully disqualified those who are undischarged insolvents, prohibited from trading the securities market etc. But some of these disqualifications, especially section 29(c) seem to strike at the heart of modern insolvency law. If the purpose of the IBC is to rehabilitate financially distressed companies, this comes from a recognition that a default alone is not

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https://www.mondaq.com/india/insolvencybankruptcy/1065376/pre-packaged-insolvency-resolution-process-section-29ac-and-h-exemption-for-resolution-applicant-or-msme-debtor; Tushar Kumar, *Applicability of Section 29A to Pre-Packaged Insolvency Resolution of MSMEs*, INDIACORPLAW (Apr. 30, 2021), https://indiacorplaw.in/2021/04/applicability-of-section-29a-to-pre-packaged-insolvency-resolution-of-msmes.html; Raghav Agarwal & Priyasha Goyal, *Pre-packaged Insolvency Resolution Process for MSMEs,* IBC LAWS (Apr. 6, 2021), https://ibclaw.in/pre-pack-insolvency-resolution-process-for-msmes/.

[165] 2019 SCC OnLine NCLT 7369.

[166] *Id.* ¶ 3.

sufficient to write off a corporate debtor. If this is the case, some benefit of doubt ought to be extended to the incumbent management and promoters of the company as well.

Conclusion

This Paper attempted to give an overview of section 29A and the rapid growth of its importance under the IBC's insolvency resolution framework. Though its applicability began with the insolvency resolution process and liquidation, it slowly expanded into other areas of corporate law in India through judicial interpretation and eventually legislative amendment. The underlying implication of section 29A(c), that incumbent managements of defaulting companies are somehow less capable to participating in the company's rehabilitation has been repeatedly challenged. The inception of the IBC was based on the notion that businesses and promoters should be allowed to fail. Thereafter, specific suggestions to make section 29(c) more reflective of economic downturns and external factors that influence the success of a company were provided by experts through the Insolvency Law Commission Report. The decision to introduce section 29A in the early stages of the IBC seems to have been heavily influenced by difficult cases such as *Synergies Dooray*. The IBC, though still a relatively nascent regime, has gained considerable experience over the past five years. With the implementation of a general pre-pack framework imminent and the consequent tilt towards a debtor-in-possession regime, it may be time for the IBC to once again trust creditors to test the capability of resolution applicants without the strictures of section 29A(c).