Attempt of Corporate and Insolvency Laws to Protect Corporate Debtor from Its own Management

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1. Introduction

Insolvency and Bankruptcy Code, 2016 (IBC) is a comprehensive enactment that provides a solution to companies dealing with financial troubles. The object of the act, as has been reiterated in various judgments is to enhance the probability of revival and continuation of companies which have limited recourses and to safeguard it from corporate death. But, In *Swiss Ribbons**[1]* the court also mentioned that the primary objective of the legislation, additionally, is to protect the corporate debtor from its own management. This is because the debt that has arisen and the insolvency process that a corporate debtor is facing might be a consequence of decisions which a management has taken. To attain this objective, in this article we will analyse how Section 29A of IBC is extended to Section 230 of the Companies Act, 2013 considering the Supreme Court's decision in *Arun Kumar Jagatramka vs. Jindal Steel and Power Ltd. & Ors (2021) ibclaw.in 46 SC **[2]***.

2. Relationship between Section 230 under Companies Act, 2013 and Section 29A of IBC

Section 29A provides a list persons ineligible to submit a resolution plan. This list under clause (g) includes promoters and management against whom an order has been passed by the adjudicating authority with respect to preferential transaction, undervalued transaction, or fraudulent transaction. This means that such persons will not be allowed to take part in the insolvency resolution process of a corporate debtor.

Section 230 of the Companies Act 2013 envisages the power to compromise or make arrangements with creditors and members.[3] After the introduction of IBC in 2016, Section 230 also provided that an application for winding up can also be brought forward by a liquidator appointed as per the provisions of IBC.

IBC has laid down three methods through which revival of a corporate debtor can be achieved. These are:

1. Initiating a Corporate Insolvency Resolution Process as per Chapter II of the code;
2. Sale of a company undergoing liquidation as a going concern as per the Liquidation regulations;
3. After an order of liquidation has been passed as per the code, a scheme of arrangement and compromise is arrived at as per Section 230 of the Companies Act, 2013.

The ineligibility provided under 29A is specifically made for the insolvency resolution process and

sale of a company undergoing liquidation as a going concern. The latter is brought under the purview of 29A through an amendment which added a proviso to Section 35(1)(f) which takes note of powers of liquidator. But there was no express extension of the same for the third mode of revival unlike the former two.

3. The Recent Judgment

This uncertainty came for consideration in the case of *Arun Kumar Jagatramka**[4]***. Arun Kumar was a promoter of GNCL which moved an application under section 10 of the IBC for initiation of corporate insolvency resolution process. After such deliberation, the liquidation process began with respect to the GNCL who is a corporate debtor. The promoter then filed a scheme of compromise and arrangement under Section 230 of the companies act which was accepted by the NCLT. JSPL was an unsecured creditor who appealed this decision to NCLAT which held that a person who is ineligible under 29A of the IBC to submit a resolution plan would also be ineligible under Section 230 to propose a scheme of arrangement.

The Apex court considered the amendment that was introduced to the liquidation regulations in the form of Regulation 2B, which through a proviso clarified that person ineligible under the code to submit a resolution plan would also be barred from proposing a scheme of arrangement under the 2013 act. The court discussed the intention of IBBI to propose the said amendment which was to remove the difficulties in implementation of ineligibility for the concerns under Section 230. As arguments were made to challenge the validity of 2B because it transgressed the authority of IBBI into the Companies Act, the court held that even if this amendment were not brought into the text, through purposive interpretation the ineligibility under 29A would have been extended to Section 230 of the act.

A submission of scheme under section 230 has a lot of similarity to a submission of resolution plan. In both cases, the objective of the submission is the revival of company and it becomes of a binding nature of approved by the committee and the tribunal. Now, if certain restrictions are imposed via Section 29A on submission of resolution plan, the same intention is bound to be carried forward to the company's act. Another important point to be noted here is that only when a company is undergoing liquidation in terms of the provisions of IBC by proposing a scheme under the 2013 act, Section 29A will come into play to bar ineligible resolution applicants from submitting a proposal.

In conclusion, the Supreme Court upheld the decision of NCLAT and affirmed that applicants who are ineligible to submit a resolution plan under 29A would also be ineligible under S. 230 with respect to proposing a scheme of arrangement.

4. Regulation 2B under the Liquidation Regulations: The Object

Section 35(1)(f) was amended which deals with the power of liquidator. This clause lays down powers of liquidator with respect to sale of movable and immovable properties of the corporate debtor. Through this amendment, a proviso was inserted which disallows sale to person who are ineligible to a resolution applicant. This clearly referred to Section 29A which lays down the list of

persons who are ineligible to submit a resolution plan. Earlier, the provisions of IBC did not bar any person to submit a resolution plan for the revival of corporate debtor. To this effect, concerns were raised that why would the promoter or management that was involved in circumstances through which default has arisen, be allowed to take part in the resolution process of the company. By allowing this, the management because of underlying interests may try to reclaim the control over the company. This amendment has made it clear that 29A even though introduced in Chapter II, would not only apply to insolvency resolution process but also to the liquidation process.

The intention of legislation is also clear from the clauses (c), (e), (f), (g), (h) and (i) that the conduct of management would not only be limited to the corporate debtor but also to other companies.

5. Why the Promoters/Related Parties should not Interfere with the Decision.

It is understood that the object of the act is also to protect the corporate debtor from its own management. The promoter would be the most instinctive in relation to a corporate debtor. Here are few reasons as to why is it necessary to exclude the promoters from insolvency process.

There have been instances when promoters have been able to submit a resolution plan with more than 90% haircuts on creditors. Same was seen in the case of *Synergies-Dooray*[5] where the NCLT allowed to settle the liabilities to creditors at discount of more than 94%. Needless to say, no creditor would agree to such a haircut and such scenarios are a consequence of abuse of process of law. In this case, the resolution plan was submitted by one of the promoters.

In a number of cases, no plans are submitted by the creditors and hence the settlement takes place according to the sole plan submitted by the promoter. This leads to heavy discount of liabilities and there arises a detrimental situation for the creditors.

There have been several arguments against the barring of promoters. One is that barring promoter as a class is detrimental to the overall functioning of business. Where there is a business opportunity, there also arises a possibility of failure. This ban would disincentivise people from investing in ideas and sometimes the reasons for the failure of promoter might be limited to unfortunate outcomes. A solution to this could be relaxing of Section 29A. When there are no buyers and bidders for the company, the company should be allowed to be given back to the promoters on conditions that they would infuse more investment and employment of people continues.

As far as the current law is concerned, the Supreme Court has made it clear that the object of the law is to protect the debtor from its own management and in no circumstances such provisions can be taken lightly.

Reference

[1] [2019] ibclaw.in 03 SC

[2] *(2021) ibclaw.in 46 SC*

[3] Section 230, Companies Act, 2013

[4] *(2021) ibclaw.in 46 SC*

[5] Lenders take 94% haircut in Synergies insolvency. Business Standard.

https://www.business-standard.com/article/companies/first-insolvency-case-sees-94-haircut-for-lenders-117082500026_1.html