

Determining Eligibility of Resolution Applicant in View of Section 29A of IBC, 2016



*Resolution of the Corporate Debtor through CIRP is one of the principal objectives of the IBC, 2016. Under this legislation the responsibility of inviting investors or prospective resolution applicants (PRAs) has been entrusted upon Resolution Professional. Initially, any person/company could come as a PRA as there was no criteria prescribed in the Code. However, just after few resolutions, it was realized that this was a big lacuna in the Code, as defaulting promoters, and management, who either directly or through related entities, were able to buy back their companies at discounted prices. This led to the introduction of Section 29 A through an amendment. This article is an attempt to explain the various provisions of Section 29 A, its relevance and the jurisprudence developing around it. **Read on to know more...***



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1. Introduction

Enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/the Code), introduced a comprehensive legal framework to deal with increasing defaults in repayments of debts, in a manner where interests of all the stakeholders are balanced. Though the IBC stipulates provisions both for resolution & liquidation for an ailing corporate entity, the first initiative should always be to revive the insolvent enterprise by undertaking Corporate Insolvency Resolution Process (CIRP), a process envisaged under Chapter 2 of the Part II of the Code. In this process, an Insolvency Professional is appointed as Interim Resolution Professional (IRP)/ Resolution Professional (RP). The RP is required to invite Prospective Resolution Applicants (PRA) to come forward and submit resolution plans. Originally, under the Code, any person could come as PRA and the Code did not prescribe any basis or criteria for selection of the resolution applicant. However, just after few resolutions, it was realized that this was a big lacuna in the Code, as defaulting promoters and management, who either directly or through related entities, were able to buy back their companies at

discounted prices. Moreover, it was also felt that allowing people who are willful defaulters in other companies or has account NPAs for more than a year or have not complied with laws in the past or have been involved in undesirable activities, to acquire a failing company, involving haircut by creditors, would be highly inappropriate.

Sensing the above alimonies, the Insolvency and Bankruptcy Code (Amendment) Ordinance was promulgated on November 23, 2017, which was later replaced by the Insolvency and Bankruptcy Code (Amendment) Act, 2017 dated January 19, 2018. There are all together 10 clauses in the said Amendment Act, the most important being Clause 5, which introduced a new Section 29A to the Code, which enumerates person who are ineligible to submit Resolution Plan for revival of an insolvent entity under the Code.

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2. Layers of Ineligibility under Section 29A

On meticulous study of Section 29A, it is observed that the reach of Section 29A extends to four layers which are:

- a) Ineligibility of person being a *resolution applicant*, itself
- b) Ineligibility of “*connected person*” to the resolution applicant
- c) Ineligibility of “*related party*” of connected persons; and
- d) Ineligibility of a person “*acting jointly or in concert with*” a person suffering from any of the above ineligibility.

It would be pertinent to apprehend the above terms before going to the 10 restrictive clauses from (a) to (j) of Section 29A.

(a) **Resolution Applicant:** Originally, clause 25 of Section 5 of the Code defined a resolution applicant as a person who submits a Resolution Plan to an Insolvency Professional. However, after series of amendments, a resolution applicant is now a person who individually or

jointly with any other person, submits a Resolution Plan in response to the invite by Resolution Professional in compliance of eligibility as stipulated by RP in consultation with Committee of the Creditors (CoC) as per Sec 25 (2) (h) of the Code.

(b) **Connected Person:** The word “connected persons” appear in clause (j) of Section 29A. Connected persons” have been defined so as to include three categories –

- (i) Any person who is the promoter or in the management or control of the resolution applicant; or
- (ii) Any 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; or
- (iii) The holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii) above.

However, clause (iii) above is not applicable to a resolution applicant where such applicant is a financial entity and is not a related party of the Corporate Debtor. Also, the scope of “holding company, subsidiary company, and associate company”, does not include the financial entities like scheduled banks, Asset Reconstruction Company, Alternate Investment Fund, Foreign Banks, etc. regulated by bodies like SEBI, RBI, etc., that have become related party of the Corporate Debtor solely on account of conversion or substitution of debt prior to the Insolvency Commencement Date, and are hence eligible to submit the Resolution Plan.

(c) **Related Parties:** Section 5 (24) of the Code provides for the definition of the related party of the Corporate Debtor. The list of 'related party' to the Corporate Debtor includes directors, partners or key managerial persons and their relatives also. The definition is from the perspective of Corporate Debtor only. Further, the definition under Section 2 (76) of the Companies Act, 2013 becomes relevant in determining related parties in case resolution applicant or any person connected to it is a corporate entity.

(d) **Person Acting Jointly or in Concert:** *The expression 'acting jointly or in concert' is nowhere defined in the Code.* Therefore, the definition of person acting in concert

(PAC) will have to be borrowed from the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 (Takeover Code) that defines PAC as persons who have the common objective or purpose of acquisition of shares or voting rights in, or exercising control over a company pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in or exercise of control of the company. It also provides an inclusive list of persons, who would be deemed to be a PAC, unless the contrary is established.

In general parlance, acting jointly signifies two or more persons acting together as a group. In the case of *Arcelor Mittal India (P.) Ltd. v. Satish Kumar Gupta*¹, the Supreme Court clarified that the expression “acting jointly” in the opening sentence of Section 29A should not be confined to “joint venture agreements” but has got broader connotation.

3. Clause wise analysis of Section 29A

There are altogether 10 clauses (a) to (j) in Section 29A. It is important to note that as per the Section 25(2)(h) the Resolution Professional is primarily responsible to ensure that the resolution applicant meets the criteria both as determined by Resolution Professional (RP) in consultation with the Committee of Creditors (CoC) and those specified in Section 29A of the Code. The Section 29A states that a person shall not be eligible to submit a Resolution Plan, if such person, its promoter or director, their relative or connected person or any other person acting jointly or in concert with such person falls under any of the clauses discussed below:

There are altogether 10 clauses (a) to (j) in Section 29A. As per Section 25(2)(h), the RP is primarily responsible to ensure that the Resolution Applicant meets the criteria both as determined by RP in consultation with the CoC and those specified under the Code.

(a) is an undischarged insolvent

The term 'undischarged insolvent' means a person or a company that is still going through insolvency

proceedings either under the current IBC regime or under earlier insolvency laws.

Verification: In case resolution applicant is a corporate, the status whether the applicant is un-discharged insolvent or not can be verified by checking companies details at MCA website because as soon as Insolvency Professional is appointed, he has to file INC 28, after which its status changes to under CIRP. Information can be checked also on IBBI site. For resolution applicants who are individuals there is no central database as of now and hence RP has to largely rely on Google search and search on NCLT/DRT database, besides taking a declaration from the applicant itself.

(b) is a willful defaulter

As per the Master Circular issued by RBI in 2015 (under the Banking Regulation Act, 1949), A 'Willful Defaulter' is any “unit” which defaults in meeting payment/ repayment to its lender and meets any of the criteria below:

- i. when it does not meet his obligations even when he can do so,
- ii. when it does not utilize the funds for a specific purpose they have been availed for,
- iii. when it siphons the funds neither for the purpose, they were availed for nor have it in another form of assets,
- iv. when it had disposed of the property or assets which were given for securing the loan without the knowledge of the lender.

Verification: For verifying whether the resolution applicant is willful defaulter, RP can rely upon the list of willful defaulters published by RBI time to time. Various banks also publish their list of willful defaulters, which can be consolidated, and relevant searches can be made. Further, the website of CIBIL may also be verified for finding out list of willful defaulters.

(c) Has an NPA Account

Where a resolution applicant itself (or its promoter or director, or its connected person, relative or person acting jointly or in concert), has an account or is a promoter or director of a company that has an account that is classified as Non Performing Asset (NPA), in accordance with the guidelines of the Reserve Bank of India (RBI) issued under the Banking Regulation Act, 1949 or any other

¹ *Arcelor Mittal India (P.) Ltd. v. Satish Kumar Gupta (2019), Civil Appeal No. 8766-67 OF 2019, Supreme Court of India.*

financial sector regulator, it is ineligible to give a Resolution Plan under this clause of Sector 29A, provided on CIRP commencement date one year has elapsed from its classification as NPA.

However, an exception has been carved out for resolution applicants that are financial entities not related to Corporate Debtor and MSME's.

Initially there was ambiguity as regards to at which date the NPA status is to be checked. Therefore, it was clarified through amendment in the clause, that to be ineligible the account should be NPA at the time of submission of the resolution plan. Often the resolution applicant may have more than one accounts that are NPA, in such cases for the period of one year should be seen from the date of first NPA account. Moreover, there are circumstances where an account is declared NPA from retrospective effect, in such cases date of declaration is to be considered for computation of one year and not the date from which the NPA status is effective.

There are certain exemptions provided in this clause. Often a person is unable to pay interest or principal of a loan due to certain temporary liquidity crunch and its account/s is classified as NPA. The Code provides a carve out by stating that, such a person can submit Resolution Plan, if such person makes payment of all overdue amounts with interest thereon and charges relating to NPA accounts before submission of Resolution Plan.

Besides, if a resolution applicant has an NPA account, pursuant to a prior Resolution Plan approved under this Code, then, the provisions of this clause shall not apply to such resolution applicant for a period of three years from the date of approval of such Resolution Plan.

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(d) Convicted Criminal

This clause makes a resolution applicant ineligible to present a Resolution Plan, where a resolution applicant has been convicted for any offence punishable with imprisonment either for two years or more under any Act

specified under the Twelfth Schedule of the Code or for seven years or more under any law for the time being in force. The Twelfth Schedule of the Code enlists 25 acts and empowers the Central Government to specify further laws as it may deem fit. The list covers most of the financial acts like the Companies Act, LLP Act, PMLA, Black Money Act, Income Tax Act, GST Laws, Custom Laws, pollution control norms, IBC, etc. It may be noted that the ineligibility will arise irrespective of the fact whether the conviction has occurred under Indian Laws or Foreign Laws. However, there would be no disqualification if at least two years has elapsed from his release from imprisonment. Moreover, this clause will not apply to connected person being the holding company, subsidiary company, associate company or related party of the promoter or directors of RA.

(e) Disqualified Director

This clause makes resolution applicant ineligible to present a Resolution Plan if its director or promoter is disqualified from acting as Director as per the provisions of the Companies Act, 2013. Section 164 of the Companies Act deals with the disqualification of a director. However, these disqualifications will not apply to connected person being related party of the promoter or directors of resolution applicant.

(f) Prohibition by Securities and Exchange Board of India (SEBI)

A person becomes ineligible to submit Resolutions Plan if it or its connected person is prohibited by the SEBI of India from trading in securities or accessing the securities markets. For determining the criteria owing to which an entity/ person is debarred from trading in securities or assessing the security market, one needs to comprehend the 'Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003', specially Regulation 3 & 4 of the abovesaid Regulations which lists dealings that are prohibited in security market and dealings that are considered manipulative, fraudulent, or an unfair trade practice.

(g) This clause makes resolution applicant ineligible to present a Resolution Plan if it itself or its director or promoter or any of their connected persons is or has been a promoter or in the management or control of a Corporate

Debtor in which a preferential transaction (u/s 43 of IBC), undervalued transaction (u/s 45 of IBC), extortionate credit transaction (u/s 50 of IBC) or fraudulent transaction (u/s 49 of IBC) has taken place and an order has been passed by the Adjudicating Authority (i.e. NCLT) under the Code. A doubt may arise as to what if the order passed by Adjudicating Authority, as mentioned above, is in appeal. As per the basic reading of the Code, still the ineligibility would apply. However, the ineligibility would not apply in case the above-mentioned transactions have taken place prior to the acquisition of the Corporate Debtor by the resolution applicant and such resolution applicant has not otherwise contributed to these kinds of transactions.

(h) Where a resolution applicant itself or any of its promoter or director, or its connected person, relative or person acting jointly or in concert, has failed to honor the guarantee, fully or partly, executed by it in favor of any Corporate Debtor undergoing proceedings under IBC, it is considered as ineligible to present a Resolution Plan under this clause. It is amply clear from the bare reading of the clause, that if the guarantee is invoked, otherwise than in respect to a Corporate Debtor facing proceedings under IBC, there would be no ineligibility under this clause. Also, as held in *RBL Bank Ltd. v. MBL Infrastructures Ltd.*², there is no intent of the Government to debar all the promoters, only for the reason for issuing a guarantee which is enforceable, unless such guarantee has been invoked and not paid for, or the guarantor suffers from any other antecedent listed in Section 29(a) to (g). MSME's are exempted from ineligibility under this clause, rational for which is discussed separately.

(i) Where a resolution applicant itself or any of its promoter, director, connected person, relative or person acting jointly or in concert, meets any of the ineligibility criteria as stated above, as per any law existing outside India, it would render him ineligible to submit Resolution Plan.

(j) Finally, this clause is applicable to connected persons and makes connected persons of any of the person who meets any of the ineligibility criteria discussed in (a) to (i), also ineligible to present a Resolution Plan. The term

connected person has been defined and discussed in one of the preceding paragraphs. Resolution Professional should insist a comprehensive list of connected persons from every prospective resolution applicant with PAN and DIN.

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4. Section 29A and MSMEs

The Section 29A as originally conceived was regarded as too rigid, as only few could meet the criteria laid down and it was argued that it was detrimental for resolution process, especially for Micro, Small or Medium Enterprises (MSMEs), where it is very difficult to find interested resolution applicant other than the promoters themselves. So, the Central Government introduced certain exemptions from the applicability of the provisions of Section 29A as regards MSMEs, by introducing Section 240A which specifically dispensed the applicability of Section 29A clause (c) to (h) in case the Corporate Debtor is a MSMEs.

5. Conclusion

Verifying each and every Resolution Plan with the eye on Section 29A in a time bound manner, can be a very challenging job for Resolution Professional, especially when the number of directors, promoters, key managerial persons, holding companies, Associated Company, related parties and connected persons are in large number requiring verification of each and every person, on individual level. Any lacuna on part of the Resolution Professional may impact finalization of Resolution Plan in a timely manner and can also invite disciplinary proceeding. Therefore, a very high level of professional competence and commitment is desired of him/her. However, with the help of proper documentation, intelligently drawn comprehensive declarations from RA and efficient use of technology, professionals can effectively do their job. Further, with the evolution of Code, a number of professionals/ organizations have developed data base, technology and skills to carry out verification of Section 29A and RP may seek such services.

² *NCLT Kolkata, CA. IB. No. 270/KB/2017, CA. IB. No. 238/KB/2018, CA. IB. No. 288/KB/2018 in CA. IB. No. 170/KB/2017 dated April 18, 2018.*