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Section 230 Scheme - A Promoter's Silver Lining!

Varsha Banerjee & Sharmistha Ghosh

The Insolvency and Bankruptcy Code, 2016 ("Code") was promulgated to consolidate and amend the laws relating to re-organization and insolvency resolution, wherein, an approved Resolution Plan is a way-out for insolvent entities. Resolution Plans are invited by the Resolution Professional from prospective Resolution Applicants, to be placed before the Committee of Creditors ("CoC") for approval, which upon approval is eventually placed before the Adjudicating Authority for sanction.

Resolution Applicant, as defined under Section 5(25) of the Code, includes any person who submits a Resolution Plan to the Resolution Professional. Since there was no particular criteria or qualification of a Resolution Applicant qua eligibility, any person could be a Resolution Applicant such as a creditor, a promoter, a prospective investor, an employee, or any other person. The absence of eligibility criteria for a Resolution Applicant resulted in an option being available to the defaulting promoters, to submit a Resolution Plan and acquire assets of the Corporate Debtor at ominously discounted prices.

In order to avert a defaulting promoter from regaining control of the company at substantially discounted prices, Section 29A was introduced in the Code vide the Insolvency and Bankruptcy Code (Amendment) Act, 2018, which was preceded by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, dated 23.11.2017. Section 29A is a restrictive provision which stipulates a list of persons who are not eligible to be a "Resolution Applicant". Section 29A not only restricts the promoters from being a "Resolution Applicant" but also, inter alia, restricts the persons connected with the promoters, along with other persons who on account of their past records viz. default and/or criminal proceedings, are also considered as ineligible. The intent of the legislature to insert Section 29A was to proscribe a certain class of persons from submitting a Resolution Plan who, on account of their past history, could have an unfavorable bearing on the integrity of the resolution process under the Code.

The Hon'ble Supreme Court of India in ArcelorMittal (India) (P) Ltd. v. Satish Kumar Gupta; (2019) 2 SCC 1, laid down the much-needed jurisprudence on Section 29A of the Code, categorically stating that great care must be taken to ensure that persons who are in charge of the corporate debtor, do not come back in some other form to regain control of the company, without first paying off its debts.

In addition to the insertion of Section 29A, the Insolvency and Bankruptcy Code

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(Amendment) Act, 2018, also amended Section 35 of the Code, which provides for the powers and duties of the liquidator. While Clause (f) of sub-section (1) of Section 35 provides for selling the immovable and movable property and actionable claims of the Corporate Debtor in liquidation, the proviso to Section 35(1)(f) categorically bars the liquidator from selling the immovable and movable property or actionable claims of the Corporate Debtor in liquidation to any person who is not eligible to be a Resolution Applicant.

On the harmonious construction of Section 29A and Section 35(1)(f), it is clear that a Liquidator cannot sell to any such persons who are barred by virtue of Section 29A, which is in line with the intent of the legislature and the judiciary of control not falling back into the hands of the creditors, promoters, etc., without them having paid off their debts.

However, in a recent ruling of S.C. Sekaran v. Amit Gupta & Ors., Company Appeal (AT) (Insolvency) No. 495 and 496 of 2018, the Hon'ble National Company Law Appellate Tribunal ("NCLAT"), in view of the provisions of the Section 230 of the Companies Act, 2013 read with the decision of the Hon'ble Supreme Court in Meghal Homes Pvt. Ltd. v. Shree Niwas Girni K.K. Samiti & Ors.; (2007) 7 SCC 753 and Swiss Ribbons Pvt. Ltd. v. Union of India & Ors.; (2019) SCC OnLine SC 73 directed the Liquidator to proceed in accordance with the law, thereby, possibly allowing for the creation of an Achilles heel to Section 29A of the Code.

The appeals were preferred by the management of Hindustan Dorr-Oliver Limited (Corporate Debtor) and HDO Technologies (other Corporate Debtor) against orders of liquidation passed under Section 33(1) of the Code by the Mumbai Bench of the National Company Law Tribunal ("NCLT"). The NCLAT has directed the Liquidator to verify the claims of all the creditors and carry on the business of the corporate debtor for its beneficial liquidation, in terms of Section 35 of the Code, but before taking steps to sell the assets of the corporate debtor, take steps in terms of Section 230 of the Companies Act, 2013 ("2013 Act").

The judgment had created a 'catch-22'

situation, wherein, on one hand, the intention of the judgment is revival of the corporate debtors by keeping it as a going concern even during the period of liquidation, thereby preventing its dissolution and on the other hand, it has opened the gateways for promoters, to try and regain control of their company, which was stopped by Section 29A.

Section 230 of the 2013 Act provides for the power to compromise or make arrangements with creditors and members. The arrangement includes reorganization of the company's share capital by either consolidation of shares of the different classes or by the division of shares into shares of different classes or by both of those methods. While Section 29A debars promoters from bidding and/or presenting a Resolution Plan in the Resolution Process, there is no explicit bar on the Promoters from participating in the scheme under Section 230 of the 2013 Act.

In fact, wherein, on one hand, the Hon'ble NCLAT takes note of the law laid down by the Hon'ble Supreme Court in ArcelorMittal and Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.; (2019) 4 SCC17, that the primary focus of the legislation is revival and continuation of the corporate debtor by protecting it from its own management, on the other hand, in a subsequent judgment, categorically allows the Liquidator and promoters to suggest arrangement intended to be undertaken, as per Section 230 of the 2013 Act.

While the judgment comes as a relief to some Corporate Debtors and their Promoters, who would be keen on availing the option to present a bona fide scheme of arrangement, various other corporate debtors, by virtue of this judgment, are asserting a Scheme under Section 230 of the 2013 Act, as a stop-gap arrangement and attempting to delay the Resolution Process, thereby deviating from the intention of the Code.

The Statement of Objects and Reasons of the Code make it clear that the former framework for insolvency and bankruptcy was inadequate and ineffective, which resulted in undue delays in resolution. Therefore, one of the primary objectives of the Code is to resolve such matters in a time-bound manner, which would thereby improve the ease of doing business and facilitate more investment, leading to higher economic growth and development.

The Apex Court in the backdrop of Innoventive Industries Ltd. v. ICICI Bank; (2018) 1 SCC 407 and after consideration of the provisions of the Code, held that the Code intended that either the Corporate Debtor be taken over by another management and run as a going concern, or, if that fails, go into liquidation.

While the judgment may be an enabling mechanism from the creditor's point of view as a good realization can generally be obtained if the company is sold as a going concern, however, the Promoters, who are otherwise barred from participating in the Resolution Process, can regain control of their company by means of participating in the Scheme under Section 230 as when delays induce liquidation, there is a value destruction, which would enable the Promoters in regaining control, that too at a throwaway price.

It is unambiguous that the longer the delay, the more likely it is that liquidation will be the only answer. The liquidation value tends to go down with time due to many assets suffering from a high economic rate of depreciation. However, the said factors are not being taken into account, neither by the Hon'ble NCLAT nor the Corporate Debtors and its stakeholder, while seeking to exercise the option of a Scheme under Section 230. Additionally, the judgment also opens a Pandora's box with respect to various compliances of provisions pertaining to Section 230, in case of proceedings under the Code, primarily because the mandatory process envisaged under Section 230 of the 2013 Act is not in consonance with the statements and objects of the Code.

Interestingly, on one side, a Liquidator is allowed two years to liquidate a company, under the Code, however, the Hon'ble NCLAT has directed that the process under Section 230 of the 2013 Act, if initiated, be completed within 90 days. It is abstruse at this stage, as to whether the said 90 days is to be deducted from the already allotted two years or is it an additional period of 90 days, over the above the period of two years, allotted under the Code. Further, on a conjoint reading of both the 2013 Act and the Code, it is also intriguing to see that on one side Section 230 requires consent of 75% of the secured creditors for Corporate Debt Restructuring Plan, whereas, the Code mandates consent of 66% of the CoC, for approval of a Resolution Plan.

Admittedly, the parties have been relegated to liquidation as 66% of the CoC members were not in favour of the Resolution. Achieving consent of a higher number of 75% at the stage of the Section 230 Scheme may be practically challenging. Consequently, the ultimate success of this entire mechanism under Section 230 of the 2013 Act is more conceptual than practical, resulting in a needless delay of 90 days.

In an attempt to lay down a way forward, the Hon'ble NCLAT in Shivram Prasad v. S. Dhanpal & Ors.; Company Appeal (AT) (Insolvency) No. 225 of 2018 has further held that before approving any Scheme, the Adjudicating Authority should allow the Liquidator to constitute a CoC for its opinion to find out whether the said Scheme is viable, feasible with an appropriate financial matrix.

Interestingly, the CoC created at the time of the Resolution Process, comprises only of the Financial Creditors and stands disbanded once the Liquidation order is passed. However, in order to follow the process under Section 230 of the 2013 Act, as per the Hon'ble NCLAT, the Liquidator shall have to go by the consent of a wider net of stakeholders i.e. the secured creditors, unsecured creditors and members, and not just the Financial Creditors. Thereby, generating the requirement of creating a new CoC, comprising of inter-alia the secured creditors, unsecured creditors, and members.

The endeavor to lay down the procedure or steps to be undertaken for the implementation of the Scheme under Section 230 by the judiciary is not only inconsistent with the law in force but also goes against the object of implementation of Section 29A read with Section 35(1)(f), which ought to be considered as a cornerstone by the judiciary, before charting out any scheme of arrangement or reorganization under Section 230 of the 2013 Act.

The raison d'être of the Code is to provide a resolution which is beneficial for all the stakeholders and not just the Financial Creditor. It is required that the law is upheld accordingly so that all stakeholders derive maximum value. However, the process as sought to be introduced by the Hon'ble NCLAT interferes and restricts the rights of the other stakeholders vis-à-vis the Financial Creditors.

The primary objective of the Code is indisputably resolution over Liquidation; however, the process of resolution should not result in any benefit or preference being given to persons who are the reason for financial stress of the Company. Any ingenious method on part of the erstwhile Promoters to regain control of the Company ought to be nipped in the bud by the judiciary, more so, in light of the observations of the Hon'ble Supreme Court in Swiss Ribbons, which clearly lays down that the management of a company should not go back to the same persons who were responsible for its downfall.

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