INDIA'S FIRST MAGAZINE ON LEGAL AND CORPORATE AFFAIRS

LEX WITNESS

Volume 9 Issue 4 | November 2017

₹65 US $6 UK £4

Insight

Antitrust Risks in Pre-Merger Negotiations between Competitors

Subodh Prasad Deo
Partner,
Saikrishna & Associates

Ajay Goel
Partner,
Saikrishna & Associates

P20

Appointment of Judges:

The Big Debate

P08

let's arbitrate

International Arbitration In Japan

S. Ravi Shankar
Sr. Partner, Law Senate

P38

+ The Grand Masters 2018

A Corporate Counsel Legal Best Practices Summit Series

P26

In Conversation with The Clouds

A Microsoft & Lex Witness Knowledge Sharing Series

P42

expert speak

Mohit Goel
Partner, Sim & San

Bharadwaj Jaishankar
Associate Partner, Sim & San

P24

expert speak

Ayushi Gupta
Associate,
MCO Legals LLP

P16

expert speak

Niraj Singh
Partner,
RNS Associates

P33

expert speak

Sachin Gupta
Partner,
Dhir & Dhir Associates

Ashu Kansal
Principal Associate,
Dhir & Dhir Associates

P28

expert speak

Insolvency – A Creditor's Regime

Sachin Gupta & Ashu Kansal

In 2016, the Government enacted the Insolvency & Bankruptcy Code, 2016 (IBC), which came as a rescue for the snail-paced debt driven and clouded economy. This move by the Government provided a consolidated legal framework in place of the highly fragmented Insolvency and Bankruptcy regime in India. Ever since its inception, the code has been subject to extensive discussions and debates, which has many a times, warranted the issuance of circulars and clarifications by the relevant authorities. Off-late the attention of myriad stakeholders had shifted to a substantial loophole in the provisions of the IBC, which could make or break the sanctity of the "creditor in possession regime" that the IBC implements. Running close to the heels of this issue, the Ministry of Corporate Affairs ('MCA') and the Insolvency & Bankruptcy Board of India ('IBBI'), has already issued a Circular of Clarification.

THE ISSUE UNDER DELIBERATION

For a corporate entity that is subject to a Corporate Insolvency Resolution Process ('CIRP'), the IBC makes no mention of whether shareholders' approvals are required, yet it mandates that a Resolution Plan must be in conformity with the provisions of law. What then happens to the legal requirement of shareholders' approvals that is mandated by the Companies Act, 2013?

To elaborate in terms of specific provisions of the IBC, Section 30(2) (e) requires that any Resolution Plan must be in compliance with the provisions of any law in force, while as per Section 31, the NCLT shall approve a Resolution Plan that confirms to the requirements under Section 30(2)(e). Yet, Section 238 provides for the IBC to have overriding effect over any other law. To cast further doubt onto the actual intention of the IBC in accommodating shareholder approvals, Regulation 39(6) of the Insolvency & Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, specifically dispenses with shareholder approval that is required only as per the constitutional documents of a company, the shareholder agreements, joint venture agreements, and such other documents. Thus, pertinently, Regulation 39(6) does not in any way oust the requirements of shareholder approvals as per the Companies Act, 2013.

Safe to say, a legal ambiguity is indeed visible in the provisions of the IBC and its Regulations. For instance, in order to bring into effect a valid Resolution Plan, does the IBC mandate shareholders' approval for sale and disposal of substantially the whole of a public company's undertaking as per Section 180(1) of the Companies Act, 2013?

Indeed, very recently, on 25.10.2017, the MCA having appraised itself of the above-described anomaly, has issued a Circular containing a letter of clarification to stakeholders stating that shareholder approval will not be required for Resolution Plans that have been approved by the NCLT. The Circular refers to the relevant notes appended to the clauses of the Insolvency & Bankruptcy Code, 2015 (Bill), which explains in respect of the binding nature of a resolution plan:
"Therefore, if a plan requires stakeholders to do or not do certain actions for the successful

D-55, Defence Colony,
New Delhi-110 024.
Tel: 91(11) 42410000,
Fax: 91 (11) 42410091
E:expertspeak@dhirassociates.com

implementation of a plan, it shall be binding on all the affected parties who shall be bound to undertake the actions set out in the plan." Relying on this, the MCA has stated that any approval of shareholders/members for the resolution plan of a corporate entity, which would have otherwise been required on account of any other law, is deemed to have been given upon the approval of the Resolution Plan by the NCLT.

While the MCA Circular clarifies the issue by relying upon the preparatory texts of the IBC, the paragraphs below seek to provide an intent-based explanation that takes a holistic view of the scheme and provisions of the IBC. By way of a structured explanation, the CIRP of a Corporate Debtor is divided into two main stages: Stage 1 being 'Before the Resolution Plan', i.e., during the corporate insolvency process and Stage 2 being 'After the Resolution Plan', i.e. during the stage of its approval and implementation.

During Stage 1, the management of the Corporate Debtor vests in the Resolution Professional by virtue of two main provisions of the IBC: Section 17 read with Section 23. As per these Sections, the entire management of the affairs of the Corporate Debtor vests with the interim resolution professional, and then the Resolution Professional who is confirmed by the Committee of Creditors for the entire duration of the CIRP. It is explicitly laid down in Section 25(1) that the Resolution Professional shall "preserve and protect" the continued business operations of the Corporate Debtor, i.e. run the defaulting corporate entity as a going concern. Also, Section 28 explicitly mandates the approval of the Committee of Creditors, in order for the Resolution Professional to carry out any action that might affect the capital structure, ownership or management of the Corporate Debtor, or the rights of the creditors.

It can be argued from the above provisions that in respect of Stage 1, the IBC vests the entire management of the Corporate Debtor in the hands of the Resolution Professional, and subjects all substantial actions to approval of only the Committee of Creditors. It may be argued that due to the unsuccessful management of the corporate entity by those earlier in charge, i.e. the promoters, directors and majority shareholders, the IBC has intentionally transferred all decision making power to the Committee of Creditors, which the IBC recognizes as best suited to assess the business viability of the defaulting corporate entity. This is even truer for a private and closely held company, where the promoters are the majority shareholders - it makes no sense to allow the decision making power to vest with the shareholders once the corporate entity has defaulted in loan repayment and a CIRP has been initiated. As it is, the shareholders and promoters are responsible for business failure of the defaulting corporate entity - vesting any decision making power under the IBC will mean that they will never allow any Resolution Plan to go through.

In any case, it would be consistent with provisions of the IBC that during the CIRP, the Resolution Professional merely looks

Sachin Gupta heads the Litigation Practice of the Firm as a Partner, with prime focus on complex civil & commercial litigation and arbitration matters. He handles matters in the Supreme Court of India, High Courts and various Tribunals, other quasi-judicial and alternate dispute resolution forums.

over the assets of the company and manages its business as a growing concern. Such routine administration of the company should ideally not involve taking any major decisions that would require shareholders' approval.

Coming to Stage 2, once a Resolution Plan is decided, any strategies for restructuring of the defaulting company's debts, or selling its assets, etc. could require shareholders' approval. Now this is where the anomalous provisions of the IBC [Section 30(2)(e) and Section 238] really set up a challenge. In line with the Circular that has been issued by the MCA, it can be reasoned and argued that the NCLT's approval of a resolution plan deems it to have complied with the requirement of shareholder approval.

Once the Resolution Plan is placed before the NCLT, the NCLT must, inter alia, satisfy itself that it is in compliance with all laws in force. Recently, in light of the controversial insolvency proceedings against Jaypee Infratech, it has been mandated that the Resolution Plan must make a declaration to the effect that the interests of all stakeholders have been considered. Thus, once the Resolution Plan is approved by the NCLT, it is binding on the corporate debtor and its employees, members, creditors, guarantors and all other stakeholders involved. Thus, the NCLT's approval is presumed to have looked into the satisfaction of all interests, on account of which, shareholders' approvals have seemingly been dispensed with. Furthermore, a comprehensive reading of the provisions of the IBC seems to show that only two entities, namely, the Committee of Creditors and the Adjudicating Authority i.e. the NCLT, are involved in approving the Resolution Plan. Further, it may also be argued that any Resolution Plan, as approved by the Committee of Creditors and the NCLT, must show awareness and adherence to the applicable compliances that are focused more on regulation of the relevant industry. For example, a Resolution Plan approved by the Committee of Creditors must still comply with the notification requirements as per Sections 5 and 6 of the Competition Act, 2002. The Circular issued by the MCA explains that Section 30(2)(e) serves to ensure that resolution plans are "legally implementable". It also explains by way of example, that a resolution plan cannot contemplate 100% foreign investment, where the FDI policy caps foreign investment to only 75% in the relevant sector of the industry. Thus, admittedly to an extent, and similar to the Circular issued by the MCA, the paragraphs above enjoin principles of statutory interpretation to help iron out the legal ambiguity, and thus to an extent, provide further support to the Circular issued by the MCA. It is assumed that during the CIRP, the Resolution Professional will not be taking any drastic decisions that require approval from shareholders as also any other approvals; and that after the Resolution Plan is placed before the NCLT; the NCLT will assess whether it accommodates all interests at stake, and only then gives its stamp of approval.

BACK TO BASICS

Once an Insolvency Application is admitted by NCLT, the entire management/Board of the Corporate Debtor is suspended and the powers of the same vest with the Resolution Professional. Thus, the Code brings forth a shift towards a creditor-in-control regime, with the promoters/board of directors and members no longer having a say as well as any voting rights in the running of the defaulting corporate entity.

As questions regarding the valid and lawful application of the IBC keep coming up, it is hoped that the relevant authorities implement its provisions in a manner that retains the faith and confidence of investors and stakeholders. This will in turn serve to bring in the desired gains to both the economy and the exchequer.

Ashu Kansal is a Principal Associate having more than 10 years of experience is a Principal Associate with the firm. His main areas of expertise are banking and finance laws, securitization related matters, recovery of debts, Suits and arbitration matters.