# EFFICACY OF A SCHEME OF COMPROMISE & ARRANGEMENT DURING LIQUIDATION: CAN COMPANIES BE RESCUED FROM INEVITABLE VALUATION DOOM

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ABSTRACT

Schemes of compromises and arrangements as operative under Section 230 of the Companies Act, 2013 can prove to be an effective means of resolving the insolvency of a stressed entity, which allows the entity to emerge financially stronger from a corporate insolvency process, rather than an undesirable commercial death. The importance of schemes of compromise and arrangement under the Indian insolvency mechanism is further bolstered by the inclusion of Regulation 2B of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. On the other hand, while the comprehensive Insolvency and Bankruptcy Code ["**the Code** or **IBC**"], introduced in 2016, has solved a major policy issue that had been tormenting the Indian commercial setting until the Code's adoption – i.e., the multiplicity of laws that would apply to insolvency matters – recent data released by the statutory regulator has painted a picture indicating that the Code has not been as successful in achieving the primary commercial objective – i.e., ensuring maximization of the value of the assets of the stressed entity, as well as the recoveries made by the creditors of such stressed entity.

As is indicated by the data released, a large chunk of insolvency proceedings end up in liquidation (following either a lack of interest by Committee of Creditors in accepting the Resolution Plan presented before it, or due to lack of interest on part of the public to submit a plan for the resolution of the entity based on valuation concerns), leading to minimal recoveries being made by the creditors. Now, this situation, in the opinion of the author, can be resolved aptly if persons from the previous management of the company are allowed to submit a 'bona fide revival plan' at the juncture of the Corporate Insolvency Resolution Process ["**CIRP**"] failing, and liquidation being initiated. However, with the blanket ban put on the participation of previous promoters through the operation of Section 29A of the IBC and the ruling of the Supreme Court of India on this matter, this approach is not permitted

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under Indian law. Accordingly, through this article, the author aims to bring to light certain fallacies in the position as it exists, through a critical examination of the data as made available by the statutory authority, weighing the benefits and disadvantages that pertain to lifting this blanket ban, and an analysis of the shortfalls in the pronouncement given by the Supreme Court of India through the case of Arun Kumar Jagatramka v. Jindal Steel and Power Limited.

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# I. INTRODUCTION

Corporate restructuring in a debt-ridden company is an ostensible task. Balancing the interests of the various stakeholders makes it difficult to ascertain the right way forward. To tackle this issue and provide a consolidated approach, the statutory provisions governing mergers and acquisitions enshrined in Sections 230-232 were introduced under the Companies Act, 2013 [“**CA, 2013**”]. Accordingly, schemes of compromise and arrangements

positions itself as one of the most important instruments at the helm of any stressed entity to resolve impending financial issues which would have a detrimental effect on the operation of the company.

Apart from corporate restructuring, companies can also resort to the mechanism set forth under the IBC. The Code provides for a step-wise resolution of the debt-ridden company's revival through the CIRP process. Where CIRP fails to bring about the desired results, an alternative but mandatory path that an entity is required to take is that of liquidation.

The primary purpose for the introduction of the Code was to correct the issue that had been ensuing in the Indian environment for decades through the operation of multiplicity of laws being applicable in insolvency cases – namely, the Sick Industrial Companies Act, 1985,[1] the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act,[2] 2002, and the Board for Industrial and Financial Reconstruction.[3] Accordingly, the Code brought about a breath of fresh air for companies existing, or evaluating an entry into the Indian market, by bringing into picture a consolidated and reorganised resolution mechanism for insolvent and bankrupt persons.

The Code has always functioned on the principle "Revival before Liquidation," which is ensured through the Corporate Insolvency Resolution Process. However, once the company goes into liquidation, is there a hope for its revival? The inclusion of Section 2B in the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, which provides a 90-day timeline which shall be applicable in cases where a revival scheme is proposed after commencement of liquidation of the corporate debtor, has

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[1] The Sick Industrial Companies (Special Provisions) Act 1985 (No 1 of 1985).

[2] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (No 54 of 2002).

[3] The Sick Industrial Companies (Special Provisions) Act 1985 (No 1 of 1985), s 4.

paved the way towards opening judicial discourse on the matter; which will be aptly discussed in this article. However, what becomes troubling is that, if a company fails to attract any prospective resolution applicants in the CIRP process itself, then what happens to (i) the position of the company in the eyes of the market forces which ascertain its viability; (ii) the position of the promoters in in regards to the creditor; (iii) the valuation of the company; and (iv) the final efficacy of the scheme that is finally entered into with such a background?

Another issue which merits discussion is the intersection in the operation of Sections 230-232 of the CA, 2013, and Regulation 2B r/w Section 29A of the IBC. Section 29A disqualifies a promoter from submitting resolution plans or acquiring the assets of the entity in liquidation. Hence, this article seeks to also discuss the issue of "how the possibility of a scheme of arrangement co-exists with the principle of promoter disqualification?"

This article's central argument is structured around several key research questions, including the prioritization of settlement mechanisms over the initiation of the liquidation process under the IBC, the determination of voting shares in compromise and arrangement matters, and the extent of intervention permissible for majority stakeholders post the CIRP process. Additionally, it critically examines the compatibility of schemes of arrangement with the principle of promoter disqualification under the IBC.By delving into these multifaceted issues, the article aims to offer insights into optimizing the functionality of the IBC and CA, 2013, thereby facilitating smoother corporate restructuring processes and fostering a conducive environment for business rehabilitation in India.

Hence, this article follows the roadmap enumerated subsequently, so as to provide an all-encompassing and convincing argument to change the legal set-

up as it exists when it comes to the rescue of a commercial entity out of the compulsory liquidation process put into place by the Code.

While this part has introduced the primary issues that will be addressed in this article, Part II provides an overview of the intersection between scheme of compromise and arrangements with insolvency law as it exists in India. Accordingly, this part will consist of a close examination of the legislative operations in place and the legal holdings influencing the subject-matter.

Part III seeks to examine the compatibility of the existing criteria for admitting an entity into insolvency, and through a multi-jurisdictional analysis, seeks to determine the existence of a better alternative (if any) for the Indian set-up.

Part IV delves and presents a critical view of the concerns which, in the opinion of the author's opinion require addressing. Accordingly, the issues relating the feasibility of a blanket ban on promoters from participating in the process of revival post-CIRP and the valuation concerns that may arise if the same is not permitted will be commented upon.

Lastly, in Part V contains a summary of the arguments presented, pitfalls addressed and the solutions that may be available with India, to continue striving towards a better and more effective insolvency law system.

## II. TRACING THE INTERSECTION BETWEEN SCHEME OF COMPROMISE & ARRANGEMENTS AND INSOLVENCY

### *A. The Existing Legislative Set-Up*

In India, the provisions governing and allowing the effective implementation a scheme of compromise and arrangement in general, are enshrined under Sections 230-232 of the Companies Act, 2013.[4] The point of intersection between the Code and CA, 2013 occurs through the operation of

[4] Companies Act 2013 (No 18 of 2013), ss 230–232.

Section 230 r/w Regulation 2B of the IBBI (Liquidation Process) Regulations, 2016. Below is a discussion regarding the primary regulations that deal with the intersection between liquidation and scheme of compromise and arrangements, for the purpose of this paper.

1. THE INSOLVENCY AND BANKRUPTCY CODE, 2016

*Section 29A*

Section 29A is one of the most contentious provisions which is part of the Code. Through this, an all-encompassing bar is affected on the previous promoters of the corporate debtor, on the grounds of possession of non-performing asset accounts with the Reserve Bank of India;[5] for being an undischarged insolvent;[6] or a wilful defaulter;[7] or even on grounds for being part of preferential, fraudulent or undervalued transactions;[8] or being connected to persons disqualified under the different grounds given;[9] amongst others. This provision serves as the principal point in question in this research paper, and an assessment of its effectiveness, viability, and placed in the Code has been examined.

*Chapter III*

Post the failure of CIRP, under the Code, the AA has been empowered to immediately pass an order for liquidation in order to maximise the recoveries made through asset sales. Accordingly, a waterfall mechanism has also been placed to ensure that priority of payments are followed (considering that the haircuts would lead to a shortage of cashflow). So, as indicated Chapter III includes a comprehensive procedure put into place for the compulsory

[5] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(c).
[6] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(a).
[7] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(b).
[8] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(g).
[9] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(j).

liquidation process as directed in the Code post the failure of the CIRP process.[10]

### 2. The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016

This is the principal regulation that will be under scrutiny in this research paper. Various provisions exist which deal with scheme of arrangements and liquidation at the juncture of CIRP failing. They are as follows:

*Regulation 2B*

This provision directly deals with the subject-matter of compromise and arrangements proposed through Section 230 of the Companies Act. However, due to the presence of the disqualifying factor due to the insertion of the wording through the IBC (Amendment) Act, 2020,[11] this regulation acts as the primary hurdle for bona-fide previous promoters from submitting a revival scheme before the Committee of Creditors.

*Regulation 32(e)*

This regulation serves as a further discussion point in this paper. Through this, the tribunal-appointed Liquidator is allowed to sell off the company as a going concern while in liquidation. This point is essential for examination as the regulation showcases the primary objective of the Code, i.e., Revival not liquidation. In fact, multiple cases exist where the courts in India have emphasised on this objective. For example, in ***Arcelor Mittal India Private Limited*** **v.** ***Satish Kumar Gupta***, the SC stated that –

"*If there is a resolution applicant who can continue to run the corporate debtor as a going concern, every effort must be made to try and see that this is made possible*."[12]

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[10] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), ch III.
[11] Insolvency and Bankruptcy Code (Amendment) Act 2020 (No 1 of 2020).
[12] *Arcelor Mittal India Private Limited v Satish Kumar Gupta* [2018] ibclaw.in 31 SC [83].

In another example, the SC further pointed out the fact that the preamble of the Code in no manner mentions liquidation, indicating that the same is a last resort move when all efforts of revival have failed.[13]

### 3. COMPANIES ACT, 2013: SECTION 230

Section 230 of the Companies Act, 2013, grants the NCLT the power to sanction compromise or arrangement between a company and its creditors or shareholders. This provision enables the restructuring of companies so as to put their affairs into place, and satisfy the requirements of its members/creditors in a situation where the company is operating in a stressed-state (i.e., possible brink of insolvency)

In the context of the IBBI (Liquidation Process) Regulations, Regulation 2B facilitates the sale of assets of the corporate debtor through electronic means, ensuring transparency and maximizing value realization for creditors. Section 230 of the Companies Act can be invoked to seek NCLT's approval for a scheme of arrangement or compromise that includes the sale of assets under Regulation 2B. This synergy between Section 230 of the Companies Act and Regulation 2B of the IBBI (Liquidation Process) Regulations enhances the flexibility and effectiveness of the liquidation process under the IBC in general, but restricts the entry potential of bona-fide previous promoters of the company. This is done through the explicit mention of the barring provision of Section 29A of the Code, as part of the regulation provision itself.[14]

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[13] *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17.

[14] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 2B.

### *B. The existing Judicial Pronouncements on the Intersection of Insolvency and Schemes of Compromise and Arrangements*

The first set of directions observed to be passed by the NCLAT, ordering the liquidator to take steps under Section 230 of the Act before going ahead with the liquidation of the entity, was observed through the case of ***S.C. Sekaran* v. *Amit Gupta***.[15] In fact, through the application of the Companies Act, 1956 as well,[16] with the ***Meghal Homes*** case seeing an order being passed, where the liquidator was first required to examine any scheme proposed before it, only post which the sale of the assets of the CD would be permitted.[17] In ***Ajay Agarwal* v. *Ashok Magnetic Ltd.***,[18] the NCLAT further clarified that during liquidation, the liquidator is under an obligation to ensure that they explore the option of compromise or arrangement, which is provided through Section 230 of the 2013 Act.

Now, the support for settlement instead of liquidation has been seen to be a settled point in law. However, with the landmark ruling of ***Arun Kumar Jagatramka v. Jindal Steel and Power Ltd.***, the Supreme Court closed the path for previous promoters to present settlement/revival schemes before the CoC. The Court stated that Section 29A of the Code would also apply to cases where schemes are proposed through Section 230 of the Companies Act.[19] Further, the application of Section 35(1)(f) was also attached to the Code.[20]

Therefore, it becomes essential to examine whether this step by the Supreme Court can validly be stated to be the best possible move for the economic Code; which, due to its economic nature should be allowed to

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[15] *S C Sekaran v Amit Gupta* [2018] NCLAT Comp App (AT) (Insolvency) 495 & 496.
[16] Companies Act 1956 (No 1 of 1956), s 391.
[17] *Meghal Homes Pvt Ltd v Shree Niwas Girni K K Samiti* [2007] AIR 2007 SC 3079.
[18] *Ajay Agarwal v Ashok Magnetic* [2018] NCLAT Comp App (AT) (Insolvency) 792 & 793.
[19] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474.
[20] ibid.

operate to serve the best needs of corporate entities that come before it for the purpose of revival?

## III. INDIAN INSOLVENCY APPROACH: ADEQUACY AND EFFECTIVE IMPLEMENTATION

Applications to initiate the corporate insolvency process against an entity under the Indian Code can be brought forth by either its financial creditors,[21] its operational creditors,[22] or by the corporate entity itself through an application presented by the management of the CD or by persons authorised by it.[23]

The satisfaction of the legislation and sectoral authority with the test put in place is made evident in various places. The 'default-based test' was defined as objective criterion,[24] and as stated by Shri T.K. Viswanathan in his considered view, is the driving rationale behind the implemented Insolvency and Bankruptcy Code.[25] The setting apart factor for the Code, as compared to its predecessors in Sick Industrial Companies Act, amongst others; was the ability to detect sickness in an entity at an earlier stage, instead of implementing the worth erosion test, etc.[26]

But what requires further examination is the need additional qualifying factors which would serve as effective means to not only bring forth the best possible means for revival, and at the same time decrease the burden on the Tribunals while dealing with matters pertaining to CIRPs. A further

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[21] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 7.
[22] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), ss 8–9.
[23] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 10.
[24] Ministry of Corporate Affairs, 'Notice File No. 30/38/2021-Insolvency' (1 January 2023) para 2.1 https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf
[25] Lok Sabha Secretariat, Report of the Joint Committee on the Insolvency and Bankruptcy Code (28 April 2016) para 2 https://ibbi.gov.in/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf.
[26] ibid.

requirement that would also be examined is prospective inclusion of a benchmark for assessing the viability of the CD, so as to streamline the admission process.

Now, the principal reason for the inclusion of this discussion in the research paper is to analyse the question that – if default is the only test that is required, what will happen if the proceedings are already in an advanced stage of negotiations. Hence, should India add another qualifying test to ensure that compulsory admission of application u/s 7 and 9 do not take place if negotiations are at an advanced stage?

## IV. A CRITIQUE OF THE JINDAL STEEL CASE AND THE CONCERNED LEGISLATIONS

In the case of *Arun Kumar Jagatramka* v. *Jindal Steel and Power Ltd.*,[27] through its judicial pronouncement, the Supreme Court has, *inter alia*, quite clearly provided that-

(i) The disqualification as given under Section 29A of the IBC will be applicable to the regulations governing scheme of compromise and arrangements as envisaged in the IBC processes;

(ii) The incorporation of the barring clause for promoters in Regulation 2B of the IBBI Liquidation Regulations are *in continuum* with the provision of Section 230 of the Companies Act, 2013. Hence, the barring effect of Section 29A would be applicable to any resolution that is sought through the IBC mechanism;

(iii) The incorporation of the barring clause in Regulation 2B is constitutionally valid.

[27] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474.

Now, while the author accepts that the interpretation of the Court was in line with the harmonious principle of interpretation adopted,[28] at the same time, the author is of the opinion that the courts, the legislature and the statutory regulator have erred in dealing with the actual problems being faced while implementing a scheme of compromise and arrangements at the juncture of liquidation under the IBC. This is because the author found that all the explanations and/or justifications for any change in law, regulation or precedent with respect to the IBC have been fixated with aligning them with the objectives of the IBC, even though there may be evident hurdles that may be faced. Further, there also exists an unsaid weightage difference given to the various objectives of the IBC, which, in the opinion of the author, in fact turns to defeat major objectives of the IBC. Lastly, it is also the author's opinion that the *status quo* has resulted in an additional hurdle in achieving what they feel is the primary goal of the Code, that is 'revival before liquidation.'[29]

### *A. Feasibility of Blanket-Bans on Promoters in a Scheme of Arrangement during Liquidation*

At the outset, the author finds it pertinent to clarify that the operation of the barring provision under the Code is only being criticised with respect to the application of sub-clause (j),[30] while taking into consideration a scenario where a CD has emerged unsuccessful from the resolution process.

The examination in this sub-part presents the argument that the operation of sub-clause (j) of Section 29A prevents entities and creditors from exploring an alternative and viable option – i.e., settlement of the dispute post the

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[28] ibid para 70.

[29] *K N Rajakumar v V Nagarajan* [2021] SCC OnLine SC 1792, para 16; *Gayatri Polyrub Pvt Ltd v Anil Kohli* [2023] NCLAT Comp App (AT) (Insolvency) 650, para 6; *Ghanashyam Mishra and Sons Private Limited v Edelweiss Asset Reconstruction Company Limited* [2021] SCC OnLine SC 313, para 86.

[30] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(j).

unsuccessful resolution process, and prior to the initiation of the liquidation process. Neither does this sub-part advocate for the removal of the barring provision in its entirety, nor does it advocate for the inclusion of promoters barred under sub-clauses (a) – (h) of the Section of the Code. The analysis is purely on the lines of whether the extension of application of sub-clause (j) should be allowed to prevent bona-fide revival schemes offered to creditors a previous promoter of the entity.

### *B. Bringing Clarity to the Matter: The Primary Object of the Code*

As was stated in the introduction to this research article, the primary goal of the IBC is "Revival before Liquidation." However, as displayed by the discussion in Part II, there now exists various statutory and judicial obstacles to allow for such cases of revival to occur where a bona-fide previous promoter, not disqualified under Sections 29A(a)-(g) of the Code brings forth a *bona-fide* revival plan.

It is essential to note that the IBC is an economic code. It serves the purpose of ensuring that a sick company gets effective revival, and where the company is a majorly gone-case, its aim is to maximise the assets of the CD, so as to ensure that the creditors of the entity make the highest amounts of recoveries of their dues. However, it may be noted that through the discussions made in the cases of *Swiss Ribbons* and *Arun Kumar*,[31] the economic objective has taken a sort of a back-seat when it comes to the revival of companies under the Code.

While the author does understand that the responsibilities of the AA are vast, with objectives having to be *creditor-centric* here, *central-objective centric* there. However, through-out all of this, in the opinion of the author,

[31] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474; *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17.

the contributions made by a commercial entity in the economy of the country is severely disregarded in the opinion of the author. In their opinion, while the persons in the previous management of the company should not be a priority; yet, effecting the revival of the entity while putting the interest of the CD also at par (to the extent possible), could lead to an eye-opening moment, which inevitably allows for the realisation of the true object behind the Code.

Another objective of the Code which is pushed for heavily through its provisions is the ensuring the completion of the CIRP process in a timely manner. Due to this, various directory timelines have been provided under the IBC, which, even though not mandatory, can only be extended through an application made to the Adjudicating Authority.[32] Now, with sticking to the timeline being a further objective, the operation of Section 29A is justified as preventing unnecessary litigation initiated by previous promoters, along with the immense time taken by a Resolution Professional in conducting the due diligence for the admission of resolution plans. However, the author has observed that this cannot be one of the primary considerations justifying the application of Section 29A, when the alternative that exists leads to an even worse output[33] –

[32] *Surendra Trading Co v Juggilal Kamlapat Jute Mills Co Ltd* [2017] 16 SCC 143.
[33] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 15.

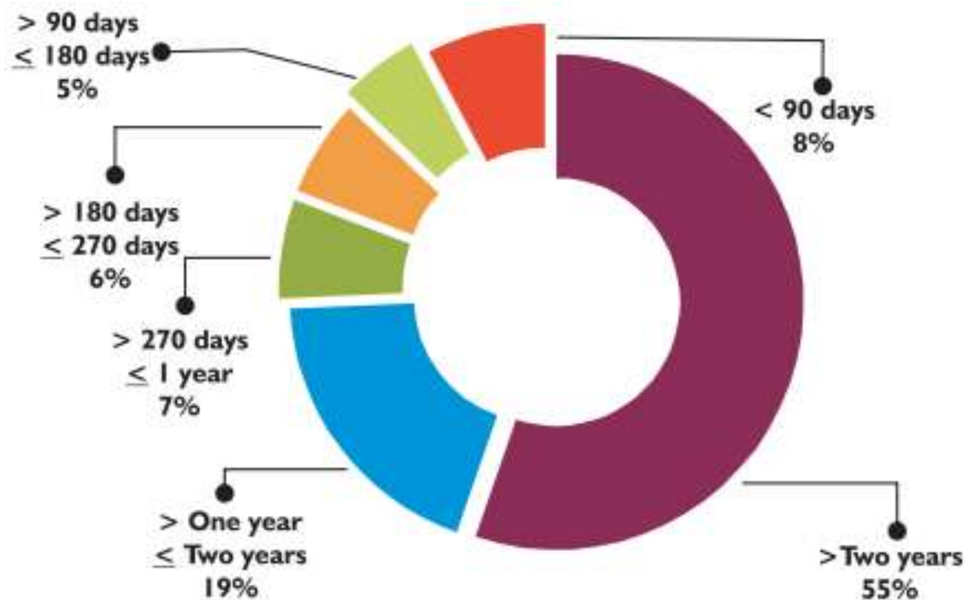


***Figure:*** *Actual timeline for liquidation under the Code*

As observed by the above, it is evident that liquidation at the same time has not had a positive impact on the timeline objective of the Code, with more than half of the cases taking more than 2 years to be settled. While the timeline under the Code may be directory, in the opinion of the author, it cannot be made individually directory in some cases, and be considered a boon in others.

### 1. THE ULTRA VIRES NATURE OF THE REGULATION 2B AMENDMENT & ALTERNATE OPERATION THROUGH COMPANIES ACT, 2013

It is mooted that the application of Regulation 2B, which is the only provision of law under the Code which permits the disqualification under Section 29A to be operable in the cases of schemes under Section 29A, is ultra vires of the Code due to the following reasons –

(i) The IBBI overstepped in their regulations by making an incorporation by reference to Section 230 of the Companies Act through Regulation 2B;

(ii) The general application of the Code and its regulations should ideally only be for matters dealing with insolvency, and not get overarching powers over other primary legislations.

(iii) The dual role of the Adjudicating Authority

2. APPLICATION OF THE CODE: SOLELY FOR INSOLVENCY MATTERS?

The author contests that the procedure as enshrined under the Companies Act should remain independent from that of the Code. This is as two different mechanisms have been put into place in the two Acts, requiring different level or approvals, and also from different set of parties. Now, as there is no mention of scheme of compromise and arrangements in the principal Code, and as a mention is only found in regulations, it is necessary for only matters pertaining to insolvency *'which are mentioned in the Code'* to be brought for adjudication before it, rather than bringing any process involving elements of insolvency in its purview.

An example of what the author is trying to point out is made evident through the Competition Act itself.[34] It is pertinent to note that the Competition Act differs from the Code on the point that there is in fact an actual mention of schemes of compromise and arrangements (through the use of words such as mergers, amalgamations and acquisitions) present in the Act. However, even though this may be the case, the Act deals solely with matters pertaining to competition laws, and all matters of scheme of compromise and arrangements are dealt through the application of Section 230 of the Companies Act itself. Now, here, while the disqualifications to schemes under the Companies Act is done when adverse impact on competition in the market is detected through such a proposal,[35] there is still no overarching operation of the Act on the Companies Law.

Accordingly, since there is no explicit mention of scheme of arrangements in the primary Code, there should be a removal of the application of the bar under Section 29A on matters pertaining to Section 230 of the Companies Act.

[34] Competition Act 2002 (No 12 of 2002), ss 5–6.
[35] Competition Act 2002 (No 12 of 2002), s 3.

### 3. DUAL ROLE OF THE ADJUDICATING AUTHORITY

It has already been noted in practice that the bar imposed by Section 29A can be lifted by the Adjudicating Authority if required under the circumstances. This move was seen in the case of *Arcelormittal India Private Limited* v. *Satish Kumar Gupta*,[36] where, the Supreme Court permitted ArcelorMittal and Numetal to remove their disqualification and present a resolution plan.[37] In fact, the dual role played by the Tribunal in the cases of Section 230 being operative along with the Code is in two ways – (i) as the authority overseeing liquidation under the Code; and (ii) as the Tribunal issuing orders for the carrying out of the arrangements under Section 230.[38]

Now, if the dual role of the Adjudicating Authority is recognised, and adjusted according to the principal legislation that the subject-matter of the case is related, then why is there a difference in the manner that the barring provision of 29A of the Code is applied? Hence, it becomes essential to put the dual Adjudicating Authority's powers of supervision under the Code and scrutiniser in terms of the Companies Act into use, and ensure that the creditor's interests are more aptly protected by the courts of India instead of having an all-encompassing barring provision.

### 4. EQUITABLE OPERATION OF BARRING PROVISION CONTAINED IN SECTION 29A

*Comparison to Section 12A withdrawals*

Section 12A of the Code allows for the withdrawal of an application for CIRP, if the requisite 90% voting in terms of credit value is achieved.[39] Withdrawal can be a consequence of a full settlement with the applicant,

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[36] *Arcelormittal India Private Limited v. Satish Kumar Gupta* [2018] ibclaw.in 31 SC.

[37] *Aggarsain Spinners Ltd v Shreeji Cotfab Ltd* [2022] ibclaw.in 141 SC; Insolvency and Bankruptcy Board of India, *Emerging Ideas on IBC* (2023) 88.

[38] *Y Shivram Prasad v S Dhanapal* [2018] SCC OnLine NCLAT 692.

[39] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 12A.

through a full settlement with other creditors, through an agreement to settle in the future, amongst others. Enumerated below is the data released by the IBBI indicating the reasons for withdrawals witnessed in the Indian climate[40]

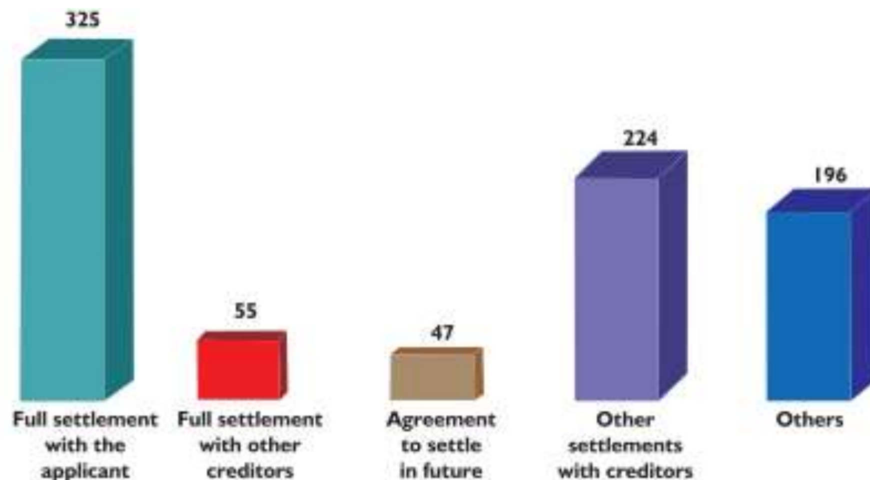


***Figure 1:*** *Reasons for Section 12A withdrawals*

The consequence of a Section 12A withdrawal is the re-instating of the entity with its previous management, following an understanding which in most cases concerns a settlement through Section 230 of the Companies Act, 2013. Hence, as the withdrawal application is a part of the settlement mechanism and not the resolution mechanism, the Section 29A disqualification does not apply to it. Accordingly, it can be contested that since a scheme of compromise and arrangement at the juncture of initiation of liquidation should be considered as a part of the settlement process, relieving it from the barring nature of Section 29A of the Code.

Further, it has been held by the Supreme Court that since a Section 12A withdrawal occurs at the initiation of the CIRP process, it can be withdrawn without much thought. Translating the same logic onto the case of a Section

[40] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 15.

230 scheme at the liquidation juncture would make the Section 29A barring provision inapplicable.

*Comparison with the case of MSMEs*

Considering the requirements of Micro, Small & Medium Enterprises ["**MSMEs**"], and a separate resolution mechanism was introduced in the form of Pre-packaged Insolvency Resolution Process.[41] In this process, the disqualification u/s 29A has been made inapplicable, as "*excluding such industries from disqualification under 29A (c) and (h) is because qua such industries other resolution applicants may not be forthcoming which thus would inevitably lead not to resolution but to liquidation*."[42]

Further, it has also been observed by the Supreme Court as a matter of fact that MSMEs are able to attract lesser consideration from prospective resolution applicants than companies. However, considering the situation of an entities being referred to in this paper (i.e., ones which received no resolution through the CIRP processes and where liquidation has been initiated), it also becomes an essentiality to consider the position of promoters in their own regard.

The Court in this case also stated that the reasoning behind the relaxation afforded is that "*the business of an MSME attracts interest primarily from a promoter of an MSME and may not be of interest to other resolution applicant*."[43] The same can be said about a similarly placed CD which fails to attract successful resolution applicants and is doomed for an inevitable liquidation.

*The Commercial Morality Element: Threatened?*

[41] Insolvency and Bankruptcy Code (Amendment) Act 2021 (No 26 of 2021) para 8; Insolvency and Bankruptcy Code 2016 (No 31 of 2016) ss 54A-54P.
[42] *Hari Babu Thota v X* [2023] SCC OnLine SC 1642.
[43] ibid.

A term that was time and again mentioned in the judgment, either through the arguments of the counsels taking the opposing stand, or through the pronouncement of the Court,[44] that allowing the previous promoters to gain a backdoor entry to the helms of the company would lead to a case threatening commercial morality. This, in their opinion would occur owing to the haircuts that an entity receives through the process as enshrined under the Code, to effect a settlement of the dues.

While this logic stands in a case where unscrupulous elements from the previous management enter the process, it operates as flawed in cases where the promoters themselves were not at fault for the insolvent status of the company.[45] It is also made evident from the data presented below that most of the companies entering into the insolvency process are directed towards the same through the actions of the creditors and not the management of the company itself-[46]

[44] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474, para 64.
[45] *For example*, see section IV.A.v ('Digitalisation of IBC').
[46] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 12.

***Figure 2**: Share in initiation of CIRP figures from the different stakeholders*

This, while not sufficient data (owing to different factual scenarios of differing cases), can act as persuasive value to show that the haircuts that occur in the process is a result of natural economic degradation, and that such haircuts if even accepted, would be a result of the collective decision of the Committee of Creditors. This ensures that the commercial morality element that is generally threatened through such an arrangement would not see operation. Further, the inclusion of honest promoters to the helm of the company would be a result of a CoC-approved 'front-door entry.'

## 5. ROLE OF THE COMMITTEE OF CREDITORS

The role of the Committee of Creditors in the mechanism laid down under the IBC is paramount. It is the ultimate decision-making body for determining the faith of the corporate entity in distress. Since the Committee of Creditors consists of creditors representing all the admitted claims against a CD, it becomes the perfect body to make decisions regarding settlement of dues, ascertaining the viability of the corporate debtor, as well as a resolution plan

adding the requirement of 90% of the Committee of Creditors instead, would serve to ensure that an economically viable and suitable plan is accepted by the Committee, even if it has been submitted by a previous promoter. Further, considering the fact that the elevation of the previous management back into the management of the CD was the concern of the creditors post which the barring provision was added,[51] their consent itself would have paramount weightage on the authenticity and workability of the settlement plan. If an overwhelming majority of the creditors feel that the revival plan is apt and suitable for the stressed entity, then the Statement of Objects behind the introduction of Section 29A should not be blindly followed.[52]

Apart from this requirement, the following should also be incorporated to ascertain the *bona fide* nature of the revival scheme –

- A voting share representing 90% of the total credit value should approve the settlement plan. This ensures that the plan is approved by an absolute almost majority, and allows for only the most suitable plan to be approved through the Committee of Creditors.
- Full and final settlement of all dues that are owed by the entity for the agreed upon consideration.
- Where full and final settlement of amount is to be made at a future date, a guarantee covering the overall value of debt owed, with the guarantor being a solvent person with no defaults in payment in the preceding 5 years (or a time-period which is deemed to be appropriate).

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[51] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474, para 44.
[52] *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17, para 53.

| Outcome | Description | CIRPs initiated by | | | |
|---|---|---|---|---|---|
| | | FCs | OCs | CDs | Total |
| Status of CIRPs | Closure by Appeal/Review/Settled | 264 | 688 | 7 | 959 |
| | Closure by Withdrawal u/s 12A | 232 | 609 | 7 | 848 |
| | Closure by Approval of Resolution Plan | 380 | 241 | 56 | 677 |
| | Closure by Commencement of Liquidation | 927 | 896 | 207 | 2030 |
| | Ongoing | 1109 | 831 | 113 | 2053 |
| | **Total** | **2912** | **3265** | **390** | **6567** |
| CIRPs yielding Resolution Plans | Realisation by Creditors as % of Liquidation Value | 182.7 | 125.8 | 147.5 | 168.5 |
| | Realisation by Creditors as % of their Claims | 34.2 | 17.6 | 18.3 | 31.8 |
| | Average Time taken for Closure of CIRP | 613 | 632 | 541 | 614 |
| CIRPs yielding Liquidations | Liquidation Value as % of Claims | 6.4 | 9.1 | 8.6 | 7.0 |
| | Average Time taken for Closure of CIRP | 476 | 450 | 390 | 456 |

***Figure 3****: Data depicting the haircuts faced through CIPS yielding Liquidation, as under the Code (as on March 31, 2023)*[53]

Considering the haircuts faced on a regular basis, if the previous promoters can come up with a concrete solution (considering that CIRP process takes a total of 180 days, it may be a possibility that future opportunities come up), then the same should be allowed to be subject to the evaluative mechanism set-up under the Code. It is only when a case comes up in the court that this argument can be put forth.

## 6. CASE STUDY: GO FIRST

It is essential to note that the situation that this research paper seeks to address requires the following pre-requisites for its arguments to be accepted-

- The CIRP process for the corporate entity should have failed, leading to an order of liquidation being passed by the Adjudicating Authority;

[53] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 13.

- A previous promoter [excluding those disqualified u/s 29A(a)-(i) of the Code] presents a revival scheme for the company through Section 230 of the Companies Act, 2013, r/w Regulation 2B of the Code.
- The revival scheme must be *bona fide* in nature.[54]
- The revival scheme is approved with a voting share representing 90% of the total claim value of the Corporate Debtor.

Now, while no precedence has been set as the courts in India have not had an opportunity to examine a case with such specific facts involved, there does exist an example in the form of the case study of Go First.

Go First was a revolutionary budget airline established under the name of Go Air. One of the early entrants in the Indian pocket-friendly airlines business line, Go First dominated the market, attracting customers in masses, just like its primary competitor IndiGo. In fact, the success that the company amassed was such that they had even expressed their intent to become a publicly traded company.[55]

However, the company was thrown into troubled waters for no fault of their own. In the year 2022, they were faced with a peculiar problem with their lead engine manufacturer – Pratt & Whitney ["**P&W**"]. Numerous airline companies supplied by P&W faced this issue where a rare powder metal defect,[56] which could potentially lead to the cracking of the engine components of the aircraft, left the companies with no option but to ground

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[54] *See* section IV.A.iv ('Compliance Requirements').

[55] Kala Vijayaraghavan and Rajesh Mascarenhas, 'GoAir Plans IPO to Raise Rs 3,000 Crore' *The Economic Times* (8 February 2021) <https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/goair-plans-ipo-to-raise-3000-crore/articleshow/80739170.cms?from=mdr>.

[56] FE Online, 'IndiGo Takes Strategic Measures to Address Pratt & Whitney Engine Problems' *Financial Express* (4 November 2023) <https://www.financialexpress.com/business/airlines-aviation-indigo-takes-strategic-measures-to-address-pratt-amp-whitney-engine-problems-grounding-leasing-and-more-3296808/>.

the affected air vehicles.[57] Go First faced the misfortune of having to ground 4,118 flights as P&W refused to repair or provide replacements for the defective components.[58] This led to a sudden cash crunch for the corporate entity, with the occurrence of defaults occurring as a direct consequence.

Owing to the above scenario, the Wadia Group, principal owners of Go First at that time, were forced to file for bankruptcy u/s 10 of the Code. Now, it has been reported that the Wadia Group were attempting to re-instate themselves as the owner of the airlines group, owing to the defaults in payment occurring due to no misconduct of their own. Further, due to not being disqualified u/s 29A(c) of the Code, the Group was mooting for the barring application of Section 29A of the Code to be removed in their case.

However, taking into consideration the construct of the provision itself, supplemented by judicial interpretation, an entry for such a '*prospective reviver*' becomes impossible. The all-round barring application of Section 29A of the Code has the potential to prevent a lot of *bona fide* attempts at revival of a corporate entity, which would in fact be the most viable solution for the entity. Just like in the case of the Wadia Group, various such insolvencies may be faced where the previous promoter who brings forth a revival scheme is not disqualified through the application of 29A(a)-(i) of the Code, and are thrown into the deep-end for no fault of their own. They may also possess enough credit-value to be able to facilitate the execution of guarantees for future settlement, or even to offer a scheme of full and final

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[57] Daniel Martínez Garbuno, 'The Global Impact of the Pratt & Whitney Engine Issues' (*Simple Flying,* 17 November 2023) <https://simpleflying.com/global-impact-pratt-whitney-engine-issues/>.

[58] Trisha Shreyashi, 'Go First Insolvency: A Prospective Case for a Precedent in Bidding for Control of Insolvent Entity' *News18* (23 May 2023) <https://www.news18.com/opinion/opinion-go-first-insolvency-a-prospective-case-for-a-precedent-in-bidding-for-control-of-insolvent-entity-7861711.html>.

payment, which may be satisfactory for the creditors. This would ensure that the multi-faceted objective of the code is satisfied –

- The *economic objective* of ensuring the revival of a distressed corporate entity;
- The *creditor-centric objective* of maximising the realisation of the debt owed to them; and further satisfying the criteria of treating the proceedings as a *right in rem* by providing a mechanism requiring the approval of an absolute-majority of the creditors (represented through credit value).
- The *promoter-centric objective* of allowing persons not at fault for the insolvency to present a scheme for approval before the Committee of Creditors constituted; as well as for ensuring that the effective revival of the entity is allowed by placing it in the hands of persons familiar with the entity.

## V. VALUATION CONCERNS

"*In India, it is widely accepted that liquidation is a weak link in the bankruptcy process and must be strengthened as part of ensuring a robust legal framework.*"[59]

It has been stated time and again that the primary objective of the Code through its liquidation is to provide a mechanism for the "orderly exit"[60] of the sick and distressed companies that come under the purview of the legislation. But what happens in the case where the company is not able to find a successful resolution applicant through the CIRP process? Well, while the direct answer to this question, as laid down in the Indian insolvency code is liquidation, the author is of the opinion that blindly following the route of

[59] Bankruptcy Law Reforms Committee, *Report of the Bankruptcy Law Reforms Committee: Volume I* (Government of India, November 2015) para 5.5.
[60] Insolvency and Bankruptcy Board of India, *Discussion Paper on Streamlining the Liquidation Process* (Insolvency and Bankruptcy Board of India, 14 June 2022) para 43.

liquidation might not lead to the most favourable outcome for the company, the valuation of its assets, or the creditors.

### *A. The data speaks for itself.*

The author contests that the data speaks for itself when it comes to weighing the success rate of the Indian Code in the revival and liquidation of the companies under its framework. According to the data released by IBBI regarding the IBC process up to March 31, 2023, it was observed that since 2016, out of 6,571 CIRPs initiated, only 4,515 CIRPs were closed.[61] Out of these, 2,030 cases resulted in orders of liquidation.[62]

Compared to the earlier scattered insolvency regime, distressed companies have fared better under the new comprehensive code. However, while the difficulty faced in the earlier regime was the erosion of the value of the company and its assets due to the inordinate delays faced owing to multiple stages of appeal present under the different legislations; in the current Code, the primary issue is the high number of resolutions made through the second stage of liquidation rather than the first stage of attempting company revival. This situation has led to some troublesome numbers being brought into picture. Hence, it is essential to examine whether the framework as it exists currently serves the correct purpose; considering that the numbers show that the application of the IBC has departed from its principal object.[63]

#### 1. GOING CONCERN SALES: A POSSIBLE REDEMPTION POINT?

An alternate path which can be the tipping point determining the faith of a CD under the purview of the IBC has been provided for through the

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[61] Insolvency and Bankruptcy Board of India, '*Digitalisation of IBC*' [2023] *Insolvency and Bankruptcy News* 1, 11.
[62] ibid.
[63] *See*, *n* 53.

introduction of Regulation 32(e),[64] and Regulation 32A of the IBBI (Liquidation Process) Regulations, 2016.[65] Further, a very recent amendment to the Regulations has to add an additional method of running the CD as a going concern, by granting authority to the Liquidator to run a CD which is found to be viable on evaluation, following approval from the Stakeholders Consultation Committee (SCC).[66]

It is pertinent to note that a going concern sale brings the stressed entity in a better position; considering that the collective value of the assets while also weighing the future growth expectations would yield more maximization of the value than following the process of disposal of assets separately.

It is widely recognized in economic discourse that many entities derive greater value from continuing operations as a functioning entity rather than undergoing asset disposition. Liquidation, as a collective remedy, contrasts with the individual enforcement of security interests by creditors. The rationale behind liquidation, typically overseen by a liquidator acting in a fiduciary capacity for all creditors, hinges on the belief that selling the business as a going concern or via a slump sale is likely to yield superior value for all involved stakeholders.[67]

A notable advantage of selling a business as a going concern lies in the potential transfer of various intangible assets integral to the enterprise, including contracts, leases, licenses, concessions, operational assets, human resources, and technological resources. In contrast, merely selling the physical

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[64] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 32(e).
[65] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 32A.
[66] Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations 2024, para 5.
[67] Vinod Kothari & Company, 'Enabling Going Concern Sale in Liquidation' in IBC: Ushering in a New Era (2019) 175 <https://vinodkothari.com/wp-content/uploads/2019/06/Enabling-Going-Concern-Sale-in-Liquidation.pdf>.

assets of a business may render several of these intangible assets non-transferable or subject to third-party approval for each transfer, thereby complicating the liquidation process significantly.[68]

However, it may be noted that while the above-stated points may be true; again, a daunting image is brought to the forefront from the data released by IBBI is analysed.[69]

In fact, various examples exist, even on an international level indicating that a going concern sale through liquidation may also not lead to the results that an acquirer desires. One such example is that of the Barclays group, which acquired a part of the business of the culprit of the 2008 Financial Crisis, Lehman Brothers Inc. While the Barclays group was able to acquire the portion of business at a majorly discounted rate, the process of integration of the acquired business proved to be a challenging one, with the acquired assets not proving to be as valuable as expected, in the longer run.[70] Hence, through this illustration, it becomes evident that a going concern sale does not necessarily lead to *'wasted assets being applied more fruitfully elsewhere.'*

While the author is not trying to dismiss the viability of exploring this alternative at the juncture where no other means of reviving the CD is available, the primary point that is being mooted is that if an effective and viable means of resolution, addressing all the concerns of the creditors and the company's distressed state is made by a previous promoter (who was not at the helm of any wrongful conduct in their own capacity, and is submitting a *bona fide* plan) should be prioritised over the sale of the entity or its assets.

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[68] ibid.

[69] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 16.

[70] Chitru S Fernando, Anthony D May and William L Megginson, The Value of Investment Banking Relationships: Evidence from the Collapse of Lehman Brothers (Unpublished) https://www.ou.edu/dam/price/Finance/files/Lehman_paper_resubmit_JF_mar170.pdf.

### 2. THE VIABILITY FACTOR

Lastly, it may be noted that the viability/unviability of the company in the eyes of any prospective resolution applicant or buyer of its assets is completely based on market forces.[71] There are no guidelines for what makes a company viable/unviable because it is completely based on the valuation reports referred to by the prospective buyer of the company or its assets. Hence, when a company undergoes the processes of CIRP and comes out with no successful resolution applicant, it is but obvious that the perception of the company and its resources in the eyes of the market would most likely depreciate, and result in the determination of the same as '*unviable.*' Further, while bearing in mind this point, it does not come as a shock that the total recoveries made through the liquidation process enshrined in the IBC is not at par with expectations.[72]

Hence, in the opinion of the author, it is essential to align the process under IBC and Companies Act, 2013 when it comes to compromises and arrangements made. As has been stated in the previous sub-part, in a situation where the revival mechanism under CIRP does not come to fruition, and it is seen that liquidation would not render desirable results for the creditors of the company, a blind disqualification under Section 29A of the IBC against a scheme of arrangements as proposed by a previous promoter would not be the most viable economic move.

## VI. CONCLUSION

In mature legal systems, the perception surrounding corporate insolvency has evolved from a moral failing to an acknowledgment of economic circumstances. It is now acknowledged that notwithstanding genuine business

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[71] MS Sahoo and CKG Nair, 'The Soul of the IBC' Financial Express (3 August 2023) <https://www.financialexpress.com/opinion/the-soul-of-the-ibc-critics-must-see-that-ibc-is-meant-to-enable-the-market-to-determine-viability-of-a-company/3197270/>.
[72] *See*, n Part IV.B.i.

decisions and reasonable risks taken by company promoters and management, external factors such as technological advancements, heightened competition, and shifts in government economic policies can lead to financial losses. To foster entrepreneurship, many jurisdictions have implemented legal frameworks to support entrepreneurs and offer them opportunities to revive their businesses. Moreover, there is empirical evidence suggesting that entrepreneurs can leverage their experiences and learnings from failures to accelerate the growth of their enterprises in terms of revenue generation and job creation.

In light of these considerations, the authors contend that affording second chances to promoters uninvolved in fraudulent activities within insolvent companies will promote entrepreneurship and enhance the resolution of distressed firms. Accordingly, it is proposed that default-based disqualifications be eliminated from the Insolvency and Bankruptcy Code (IBC). The author posits that the intent behind sections 29A(c) and 29A(h) of the IBC, aimed at barring individuals who contributed to a company's defaults from participating in its resolution process, can be addressed through appropriate revisions to existing legal provisions, even independently of section 29A of the IBC.

However, to fortify the effectiveness of section 29A(g) of the IBC, amendments should be considered within the framework of the IBC and Corporate Insolvency Resolution Process (CIRP) Regulations. These amendments would clarify that the timelines prescribed for the resolution professional (RP) under regulation 35A of the CIRP Regulations to evaluate potential avoidance transactions by the corporate debtor (CD) are mandatory rather than discretionary and must be adhered to. This approach ensures that the adjudicating authority promptly determines whether the previous management of the CD engaged in misconduct, thereby warranting

disqualification from submitting a resolution plan under section 29A(g) of the IBC.

Through the discussion which ensued in the preceding parts, the author has tried to advocate for the waiver of the all-encompassing bar on participation of promoters enforced through Section 29A of the Code, in specific circumstances – and specifically, a revisiting of Section 29A(j) of the Code. These circumstances are those where a *bona fide* revival scheme is presented before, and approved by the Committee of Creditors (with a vote share representing 90% of the credit value), and where the promoter proposing such a scheme has not played an unscrupulous role leading up to the corporate entity's insolvency.

However, the only way to ensure the waiver is by revisiting the object of the Code. The author has noted that with a bundle of objectives of the Code ranging from the *economic objective* of maximisation of value of assets and prioritising revival of the corporate debtor, to the *creditor-centric* objective of ensuring the settlement of dues to the fullest extent and ensuring creditor protection from unscrupulous elements, to trying to remove unscrupulous elements from a company's management; the primary purpose of the economic nature of the Code has been lost. The legislature and judicial interpretation provided the easiest solution to the problem through Section 29A. However, limiting of the overarching nature of Section 29A is necessitated to put the economic objective more in the forefront, and allow bona-fide revival plans from honest previous promoters (as observed through the case study on the insolvency proceedings of Go First). Now, what would be the opinion of the courts on the matter would only be brought to the picture when a case with such particular set of facts is presented before them.