THE INSOLVENCY AND BANKRUPTCY CODE: CHALLENGES AND REFORMS

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016 heralded a new and fresh approach towards insolvency resolution in the country. Justice A.K Sikri has identified two conflicting interests that face an insolvency regime. On the one hand, there is the interest of the creditors, while on the other there is the issue of restructuring or reviving of the insolvent company. Further, in balancing these two conflicting interests, lies the paramount economic interest of the nation, which can only be achieved if the interest of all the parties is safeguarded.[1]

Ever since it was introduced, being a completely new system, the Insolvency and Bankruptcy Code has faced its fair share of challenges. As a result, a fresh jurisprudence has emerged. This paper seeks to examine the legal issues faced, identify the possible solutions, and discuss the reforms made. It takes into account the report of the Insolvency Law Committee, the Insolvency & Bankruptcy (Amendment) Ordinance, 2018 and the Insolvency & Bankruptcy (Second Amendment) Act, 2018 from the perspective of efficient working of the Code as well as the suitability of the reforms in creating an atmosphere of ease in doing business and achieving the purposes of the Code. While many red flags were raised

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[1] V.S WAHI, TREATISE ON INSOLVENCY & BANKRUPTCY CODE 9 (1st ed. 2018).

with regards to the functioning of the code, the author has focussed on the more pertinent issues. In doing so and for the sake of understanding, the author has chosen to trace the history of the problem, various legislative and judicial interventions up to its present status.

1. INTRODUCTION

The New Insolvency process in India essentially embraces facets of rehabilitation, revival, recovery, and winding up. Therefore, the procedure is to be viewed in a holistic mode keeping all these features in mind.[2]

Prior to 2016, the insolvency laws were extremely fragmented in India among the Provincial Insolvency Act, 1920, the Companies Act, and the Sick Industrial Companies Act. The need for a comprehensive law encapsulating the entire insolvency regime was deeply felt; hence the enactment of a unified insolvency code was a welcomed step. The landmark Insolvency & Bankruptcy Code (IBC or Code) was a unique piece of law and new to the Indian legal system. It is thus not surprising that major issues have arisen during its journey in the last couple of years. This paper seeks to examine some of the major challenges facing the insolvency regime in India through an analysis starting from the root of the issues, tracing the step by step progress made to resolve them up till now.

This paper has discussed the Insolvency & Bankruptcy (Second amendment) Act, 2018 ("Amendment Act") which received the assent of

[2] *Id.*

the President of India on 17th August, 2018. The Amendment Act provides that it shall be deemed to have come into force from 6th June, 2018. As a result, the Insolvency & Bankruptcy (Amendment) Ordinance, 2018 ("Ordinance") was repealed and replaced by the Amendment Act having the same provisions as the ordinance.

2. WITHDRAWAL OF CIRP PROCEEDING PURSUANT TO SETTLEMENT

Rule 8 of the Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules, 2016 provides that the National Company Law Tribunal (NCLT), constituted under section 408 of the Companies Act, 2013 may permit withdrawal of the insolvency application on a request of the applicant before its admission. However, the Code and the rules are silent on the question of legality of withdrawal of the application after its admission by the NCLT.

This issue first came before the NCLT, Kolkata in the matter of *Parker Hannifin India Pvt. Ltd. v. Prowess International Pvt. Ltd.*,[3] wherein after analysing the code the tribunal observed that post-admission of the insolvency petition, its nature changes to a representative suit and the dispute does not remain between the operational debtor and corporate debtor alone, as through publication in newspapers etc. applications were invited from other creditors to file their claim before the Insolvency Resolution Professional (IRP).

[3] Parker Hannifin India Pvt. Ltd. v. Prowess Int'l Pvt. Ltd., 2017 S.C.C. OnLine N.C.L.T. 1724.

Similar issues were also raised in *Lokhandwala Kataria Construction Pvt. Ltd. v. Nisus Finance and Investment Manager*,[4] and *Mothers Pride Dairy India Pvt. Ltd. v. Portrait Advertising and Marketing Pvt. Ltd.*,[5] wherein the National Company Law Appellate tribunal (NCLAT) was called upon to answer whether, in view of Rule 8 of the 2016 CIRP Rules, the NCLAT could utilize the inherent powers recognized by Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 in order to allow for a compromise or settlement between the parties after the admission. In both cases, the tribunal took the view that permitting such a compromise was beyond its powers; therefore, it could not do so. On Appeal, the Hon'ble Supreme Court *prima facie* agreed with the view taken by the NCLAT. However, it opined that under Art. 142 of the Constitution of India, it had the requisite inherent power to record the settlement entered after admission.[6] Thereafter in *Uttara Foods and Feeds Private Limited v. Mona Pharmachem*,[7] the Supreme Court referred to its decision in *Lokhandwala* and observed that in view of the influx of post admission settlement cases coming before the Court, since only it could utilize its special powers to allow such settlements, relevant rules may be amended so as to give such inherent powers to the NCLT and NCLAT.

With regard to the present dispute, opinions are sharply divided.

[4] Lokhandwala Kataria Construction v. Nisus Finance & Inv. Manager, 2017 S.C.C. OnLine N.C.L.A.T. 406.
[5] Mothers Pride Dairy India v. Portrait Advertising & Marketing, 2017 S.C.C. OnLine N.C.L.A.T. 411.
[6] Civil Appeal No. 9286/2017, Supreme Court of India.
[7] Uttara Foods & Feeds v. Mona Pharmachem, 2017 S.C.C. OnLine S.C. 1404.

2.1. PROPONENTS

The proponents of recording settlements after initiation of the corporate insolvency resolution process point out that through such compromises the concerned parties can retain the ball in their own court. In other words, the management and control would continue to vest in the company itself allowing the existing board of directors, who have better knowledge of the affairs and dealings of the company to navigate the troubled period as opposed to a resolution profession, thus giving the company a better chance of survival. Moreover, once a company enters the Corporate Insolvency Resolution Process (CIRP), the investors' confidence plunges and vice versa. For example, the withdrawal of the insolvency application by Andhra Bank against HDIL, albeit before admission of the petition, saw the stock rally a healthy five per cent the same day.[8] Thus, settlement option enables the promoters to realize the value of the withdrawal of the application.

2.2. OPPONENTS

On the other hand, the opponents argue that although the insolvency application may be filed by one or more creditors the insolvency resolution process is a collective process. It must be borne in mind that all the financial creditors are part of the Committee of Creditors (CoC). The Committee of Creditors play a significant role in the insolvency resolution

[8] Shaleen Tiwari, *Settlement under the Insolvency and Bankruptcy Code, 2016: A Contrarian Perspective*, INDIA CORP LAW, https://indiacorplaw.in/2017/11/settlement-insolvency-bankruptcy-code-2016-contrarian-perspective.html (last visited Apr. 20, 2018).

process. For instance, Section 28 lists the kinds of actions which the resolution professional cannot take without the prior approval of the CoC, such as creating any security interest over the assets of the corporate debtor, change the capital structure of the corporate debtor etc. Most importantly, any resolution plan under Section 30(4) needs the requisite approval of the CoC.

Thus, if such a practice is allowed the applicant creditor could disregard the other creditors and reach a settlement best suited to him. Moreover, in such an eventuality the avenues available to the other creditors remain unclear. This practice could be misused by first filing an insolvency application so as to gain leverage and a strong bargaining position in the subsequent settlement talks. The aim of the Code in providing the CIRP was to simplify the process, allowing for such a settlement would complicate the process.

2.3. MIDDLE PATH – RECOMMENDATION OF THE INSOLVENCY LAW COMMITTEE AND THE AMENDMENT

The objective of the code as encapsulated in the Banking Law Reform Committee (BLRC) Report,[9] is that the design of the Code is based on ensuring that:

> *…all key stake holders will participate to collectively assess viability. The law must ensure that all creditors who have the capability and the willingness to restructure the liabilities must be part of the negotiation process. The liabilities of all*

[9] T.K. Vishwanathan, *The Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design*, THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, http://ibbi.gov.in/BLRCReportVol1_04112015.pdf (last visited June 20, 2018).

> *creditors who are not part of the negotiation process must also be met in any negotiated solution.*

In view of the same, the Insolvency Law Committee ("the Committee") noted in its report[10] that once:

> *…the CIRP is initiated it is no longer a proceeding only between the applicant creditor and the corporate debtor but is envisaged to be a proceeding involving all creditors of the debtor. The intent of the Code is to discourage individual actions for enforcement and settlement to the exclusion of the general benefit of all creditors.*

The Committee was thus of the opinion that the rules be amended to provide for withdrawal post admission if the Committee of Creditors (CoC) approves of such an action by a voting share of ninety per cent and the need to adopt Rule 11 of the NCLT Rules, 2016 was not considered necessary as Rule 8 of the CIRP Rules were considered adequate to address the issue.

Acting upon these recommendations, on 9th June 2018, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 was promulgated. This ordinance inserted Section 12A titled 'withdrawal of application admitted under Sections 7, 9 or 10.' The section provides that withdrawal of the insolvency application under sections 7, 9 or 10 will be allowed only if approved by 90% of the voting share of the CoC. Moreover, after Expressions of Interest (EoI) are invited and commencement of the

[10] Injeti Srinivas, *The Report of the Insolvency Law Committee*, MINISTRY OF CORPORATE AFFAIRS, http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf (last visited June 21, 2018).

bidding process takes place, no withdrawal will be allowed.[11] The Amendment Act also contains the same provision.

3. APPLICABILITY OF THE LIMITATION ACT TO THE INSOLVENCY CODE

The debate on the applicability of the Limitation Act, 1963 on the proceedings under the IBC Code is perhaps as old as the Code itself. The question has been a recurring one, arising out of the silence of the Code itself on the issue; therefore the judiciary has been called upon to answer the question. It has been dealt with by the tribunals as well as the Supreme Court.

In *SBI, Colombo v. Western Refrigeration*,[12] and *Deem Roll-Tech Ltd. v. R.L Steel & Energy Ltd.*,[13] it was held that, despite no provision of the Code specifically makes the Limitation Act applicable to it, Section 433 of the Companies Act, 2013 makes the Limitation Act applicable upon the proceedings before the NCLT, since it is also the adjudicating authority under the Code, the tribunal would apply the Limitation Act in insolvency matters as well. In *Speculum Plast Pvt. Ltd. v. PTC Techno Pvt. Ltd*.,[14] despite arguments to the effect that Section 424,425, 433,434 and 430 of the Companies Act make the Limitation Act applicable on the corporate insolvency resolution process, NCLAT relied on the rule of interpretation

[11] *President Approves Promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018*, PRESS INFO. BUREAU, http://pib.nic.in/newsite/PrintRelease.aspx?relid=179805 (last visited July 6, 2018).
[12] SBI, Colombo v. Western Refrigeration, 2017 S.C.C. OnLine N.C.L.T. 1766.
[13] Deem Roll-Tech Ltd. v. R.L. Steel & Energy, 2017 S.C.C. OnLine N.C.L.T. 465.
[14] Speculum Plast Pvt. Ltd. v. PTC Techno Pvt. Ltd., 2017 S.C.C. OnLine N.C.L.A.T. 319.

in holding that the IBC being a 'Code in itself', it should be read as it is. This rule has been approved by the Supreme Court as well; it was observed that if a law is a complete code, then an express and necessary exclusion of the Limitation Act should be respected.[15]

In *Neelkanth Township and Construction Pvt. Ltd. v. Urban Infrastructure Trustees Ltd.*,[16] the NCLAT through its order dated 11.08.2017 took the view that absence of a specific provision making the Limitation Act applicable to the Code indicates the intent of the drafters. On Appeal to the Supreme Court, while the appeal itself was dismissed, the Court through its order dated 23.08.2017 left the question of applicability of Limitation Act open.[17] In January of 2018, the Apex Court stayed the decision and took up the mantle of resolving the conundrum.[18] As of July 2018 the decision in the case is still awaited.[19]

3.1. INSOLVENCY LAW COMMITTEE

While the decision of the Supreme Court is awaited, the Insolvency Law Committee has observed that the non-application of the Limitation Act would result in the reopening of the right of financial and operational creditors holding time-barred debts under the Limitation Act to file for CIRP. It would also reopen the right of claimants to file time-barred

[15] Ravula Saubba Rao v. Comm'r of Income Tax, Madras, (1956) S.C.R. 577.
[16] Neelkanth Township and Construction Pvt. Ltd. v. Urban Infrastructure Trustees Limited, Company Appeal (AT) (Insolvency) No. 44 of 2017.
[17] Civil Appeal No. 10711/2017, Supreme Court of India.
[18] Akanksha Jain, *SC Stays NCLAT Order That Said Limitation Act Doesn't Apply To Proceedings Under IBC*, LIVE LAW, http://www.livelaw.in/sc-stays-nclat-order-said-limitation-act-doesnt-apply-proceedings-ibc-read-petition/ (last visited April 21, 2018).
[19] B.K. Edu. Services v. Parag Gupta & Associates, Civil Appeal No. 23988/2017, Supreme Court of India.

claims with the resolution professional, which may be part of the resolution plan. The committee observes that the intent of the Code was not to give a fresh opportunity to creditors and claimants to recover their capital. Thus, it recommended the insertion of a specific section making the Limitation Act applicable to the Code.[20]

3.2. THE AMENDMENT ACT

Pursuant to the recommendations, Section 34 of the Amendment Act has inserted Section 238A which unequivocally lays down that the provisions of the Limitation Act, 1963 shall apply to the proceeding or appeals under the Code.

4. VOTING SHARE THRESHOLD FOR DECISIONS OF THE COMMITTEE OF CREDITORS (COC)

Section 21(8) of the Code lays down that the decisions taken by the CoC, including the key decision of approving the resolution plan, shall be by a vote of not less than 75 per cent of the voting share of the financial creditors. Regulation 25(5) read with Regulation 26 of the CIRP Regulations provides that if all the members of the CoC are not present, they must be provided an option to vote electronically.

The high threshold of 75 per cent for decisions of the CoC poses potential problems for a number of reasons, for one, the creditors' committee does not give the right to vote to operational creditors or other creditors such as home buyers and public depositors, even if they are

[20] *supra* note 10.

above the prescribed threshold. Only financial creditors can vote in the CoC. Furthermore, the 75 per cent majority vote is a high threshold to reach practically. Different creditors have different interests and it may not be easy to bring about an agreement among all of them. Attempting to achieve this kind of a majority would significantly slow down the CIRP process. It could even be misused as a pressure tactic by big creditors, who may impose upon the debtor and other creditors such a resolution plan as serves their own interests. Unlike the Joint Lenders Forum (JLF) process, it is unclear whether the dissenting creditors have an 'exit option' under the CIRP.

Internationally, voting thresholds are below the 75 per cent. In USA, the resolution plan is required to be approved by at least 66 per cent voting share in value and 50 per cent or more voting share in number, for each class of creditors.[21] In the UK, the resolution plan requires the approval by simple majority in value of the creditors present and voting. The requirement in Singapore is that there should be approval by 75 per cent or more of voting share by value and more than 50 per cent voting share in number of creditors present and voting.[22]

This issue was considered by the Insolvency Law Committee. After considering the empirical evidence of liquidation orders passed by NCLT benches, the Committee was of the opinion that there is little substance in the fear that minority creditors are forcing the companies into liquidation. Nevertheless, to promote resolution, at no. 5 among its key recommendations, the Committee says, "in order to fulfil the stated

[21] 11 U.S. Code § 1126(c).
[22] Singapore Companies Act, 2006, § 268(3)(b).

objective of the Code i.e. to promote resolution, it has been recommended to re-calibrate voting threshold for various decisions of the committee of creditors"[23]

It recommended that the voting share for approval of resolution and other critical decisions such as extension of CIRP beyond the statutory period of 180 days under Section 12(2), replacement or appointment of resolution professional (RP) under Sections 22(2) and 27(2), and passing a resolution for liquidation under Section 33(2), be reduced from 75 per cent to 66 per cent or more of the voting share of financial creditors. The Committee recognized that it is the responsibility of the interim resolution professional/resolution professional to manage the operations of the corporate debtor as a going concern. Hence for routine decisions, it was recommended that the voting threshold be reduced to 51 per cent or more of voting share of the financial creditors.[24]

The Amendment Act has brought the recommendation of the Committee into effect by making suitable amendments to the Code.

5. INCLUSION OF HOME BUYERS AND PUBLIC DEPOSITORS AS 'FINANCIAL CREDITORS

Since the initiation of the Code, the question of protection of the interest of home buyers has been raised and confusion prevailed as to whether home buyers could initiate CIRP against their defaulting developer or builder.

[23] *supra* note 10.
[24] *Id.*

As recently as in May 2018, the NCLT Hyderabad Bench in *Col. Giridhar v. Name Construction Pvt. Ltd.*,[25] observed that "[u]nder Chapter II of the Code, only a financial creditor, an operational creditor or the corporate debtor can initiate Corporate Insolvency Resolution Process...it remains unclear under the Statute as also in the light of various pronouncements whether home buyers or plot buyers would come under any of the above categories." In *Nikhil Mehta v. AMR Infrastructure*,[26] the NCLAT held the flat buyers concerned to be "financial creditors" due to the inclusion of an assured return scheme in the contract, whereby it was agreed that the seller i.e. developer would pay assured returns to the buyer until delivery of the possession. Therefore, this was a fact specific decision and is not a general rule.

Earlier, in November 2016, responding to the demand of home buyers, an amendment was made to the Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016,[27] ("CIRP Regulations") whereby a 'form F' was provided for creditors other than financial and operational creditors to enable them to file their claims with the Insolvency Resolution Professional (IRP). The intention of the IBBI seems to hint that home buyers were neither financial nor operational creditors.

[25] Col. Giridhar v. Name Construction, 2018 S.C.C. OnLine N.C.L.T. 2377.
[26] Nikhil Mehta v. AMR Infra., 2017 S.C.C. OnLine N.C.L.A.T. 219.
[27] Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016, *available at* http://ibbi.gov.in/webadmin/pdf/legalframwork/2017/Oct/CIRP%20Regulations%20-%20after%202nd%20Amendment_2017-10-24%2017:32:27.pdf.

As a result of non-inclusion of home buyers as financial or operational creditors under the IBC, the home buyers were deprived of the right to initiate the CIRP, the right to be on the committee of creditors as well as the right to at least receive the liquidation amount under the resolution plan.

5.1. INSOLVENCY LAW COMMITTEE

The Insolvency Law Committee took note of this confusion and analysed the peculiarity of the Indian real estate sector. It noted the following[28]:

1. The agreement between home buyers and developers are for disbursement of money by the home buyer for delivery of a building to be constructed in the future, therefore disbursement of money is for a future asset.
2. The money raised from home buyers is in effect financing the project, and thus it is a tool for raising finance.
3. Not all forward sale or purchase are financial transactions, but if they are structured as a tool or means for raising finance, there is no doubt that the amount raised may be classified as financial debt under Section 5(8)(f). Therefore amount raised under a real estate project from home buyers falls within Section 5(8)(f) [Note: pre- amendment Section 5(8)(f)]
4. Usually the collective amount given by home buyers as advance for their purchase is very high and often higher than the debt owed to

[28] *supra* note 10.

banks, such as in the *Chitra Sharma v. Union of India*.[29] Despite that, banks enjoy greater protection than home buyers as they are financial creditors.

The Committee noted that the current definition of financial debt is sufficient to include the amount raised from home buyers or allottees. However to avoid confusion it recommended insertion of an explanation clarifying that such creditors fall within the definition of financial creditors.[30]

5.2. THE AMENDMENT ACT

The Statement of Object of the Insolvency & Bankruptcy (Amendment) Ordinance, 2018 as well as the Insolvency & Bankruptcy (Second Amendment) Bill, 2018 as introduced in the Lok Sabha recognizes the need to balance the interest of various stakeholders, especially home buyers etc. The Bill having received the parliamentary approval and presidential assent has now become an Act.

Section 5(8)(f) of the IBC, 2016 provides that financial debt includes "any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing". In order to bring the home buyers within the domain of financial creditors, the definition of financial debt has been expanded by the Amendment Act. Section 3 of the Amendment Act adds an explanation after Section 5(8)(f). Explanation (i) provides that "any amount raised from an allottee under a

[29] Chitra Sharma v. Union of India, Writ Petition(s) (Civil) No.744 of 2017, Supreme Court of India.
[30] *supra* note 10.

real estate project shall be deemed to be an amount having the commercial effect of borrowing." Explanation (ii) provides that the definition of "allottee" and "real estate project" are to be taken from the Real Estate (Regulation and Development) Act, 2016 ("RERA"). "Allottee" is defined under RERA in relation to a real estate project as "a person to whom a plot, apartment or building has been allotted, sold (whether as freehold or leasehold) or otherwise transferred by the promoter and includes a subsequent acquirer of such property."

The Amendment Act also introduced Section 21(6A), which provides that in case where a class of creditors to which a financial debt is owed exceeds a specified number (except where a trustee or agent is appointed under the terms of the financial debt), the interim resolution professional will make an application to the Adjudicating Authority with the name of an insolvency resolution professional, other than the interim resolution professional, to act as the authorised representative of such class of creditors. Such authorised representative will be appointed by the Adjudicating Authority prior to the first meeting of the CoC.

5.3. POTENTIAL PROBLEMS

Although the protection provided to home buyers comes as a relief to thousands of affected persons, their classification particularly as 'financial creditors' has thrown open some fresh concerns.

Firstly, the real estate sector has recently seen the enactment of Real Estate (Regulation and Development) Act, 2016 ("RERA"). There are concerns regarding conflicts arising between RERA and IBC. As per IBC

procedure, once an application is admitted and the moratorium on any other proceeding is declared. So, any on-going or fresh application before RERA would be suspended for the duration of the CIRP. The law provides that this process is to be completed within 180 days, extendable by further 90 days. Therefore, if the home buyer is unable to settle the matter with the developer or promoter and his application under IBC is admitted, the moratorium may defeat the purpose of his inclusion in the IBC.

Secondly, under Section 7 of the IBC, a financial creditor can initiate the CIRP only when a 'default' in relation to his financial debt occurs. Section 3(12) defines default as "non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not [paid] by the debtor or the corporate debtor, as the case may be." However, the Amendment Act is silent on when a default arise in case of home buyers.

6. OTHER ISSUES DEALT WITH BY THE COMMITTEE AND AMENDMENT

A number of other issues have been also considered by the Insolvency Law Committee, some of which have been accepted by the government and included in the recent amendment to the Insolvency & Bankruptcy Code, 2016.

6.1. PREFERENTIAL AND UNDERVALUED TRANSACTIONS

The IBC, like insolvency laws of most jurisdictions, includes avoidance provisions intended to avoid certain transactions which may

have a negative effect on the finances of the corporate debtor and for maximising the value of the company's assets. Sections 43 to 48 of the Code deal with undervalued and preferential transactions. Such transactions can be set aside on an application by resolution professional or liquidator.

A corporate debtor is deemed to have given preference at a relevant time when there is transfer of a property or an interest of the corporate debtor in respect of an existing debt or liability, and such transfer has the effect of putting such creditor in a beneficial position than it would have been in the event of a distribution of assets under Section 53 of the Code. However, transfer made in the ordinary course of the business or financial affairs of the corporate debtor or any transfer creating a security interest in property acquired by the corporate debtor does not constitute a preferential transaction. Such preferential transactions must be made 'at a relevant time'. As per Section 43(4), the relevant time in case of a related party, is the period of two years preceding the insolvency commencement date. In case of other persons, it is one year preceding the commencement of insolvency.

Section 45(2) provides that a transaction shall be considered to be an undervalued transaction, if during the relevant period the corporate debtor makes a gift or transfers one or more assets for a consideration lower than the actual value, provided that such transaction has not taken place in the ordinary course of business of the corporate debtor. Like, preferential transactions, for an undervalued transaction to fall within the provision of the Code, it must be made within the 'relevant period' i.e., within one year

preceding the insolvency commencement date in case of any person other than related party and within two years preceding the insolvency commencement date where the transaction was made with a related party. In the case of undervalued transactions, in addition to resolution professional and liquidator, the creditor, member or partner of a corporate debtor are permitted to make an application to Adjudicating Authority if the liquidator or the resolution professional has not reported the same.

In both cases, on an application being made to the Adjudicating Authority, an order may be made reverse the transaction in the manner described under Sections 44 and 48 for preferential and undervalued transactions respectively.

In *IDBI Bank Limited v. Jaypee Infratech Limited*,[31] the NCLT has observed that Sections 43 and 45 are made retrospectively applicable. The tribunal has noted "that the code itself has provided a retrospective effect to the provision of section 43(4)(a) wherein it is stated that it is given to a related party, during two years preceding the insolvency commencement date." The above provision indicates that the retrospective effect is laid down in the legislation itself. Thus, the look-back period for the transactions is made dependent on the insolvency commencement date, and not on the date when the Insolvency & Bankruptcy Code came into effect.

[31] C.A. No. 26/2018 in Company Petition No. (1B) 77/ALD/2017.

6.2. BAR UNDER SECTION 29A (G)

Section 29A was inserted in the IBC through an amendment[32] made in 2017 to provide a list of 'persons not eligible to be resolution applicants'. Clause (g) of it provided that a person who has been a promoter or in the management or in control of a corporate debtor in which preferential or undervalued transaction has taken place and in respect of which an order has been made by the Adjudicating Authority shall not be eligible to submit a resolution plan.

With regard to this provision, the Committee noted that a person should not be punished for acts of another person, such as a predecessor if he or she did not have a nexus with past actions that led to preferential or undervalued transactions. It recommended that clause (g) must be amended to carve out from its ambit persons who acquired a corporate debtor pursuant to the CIRP process under the Code or a scheme or plan approved by a financial sector regulator or a court of law and preferential, undervalued, fraudulent or extortionate credit transactions had taken place in the corporate debtor prior to such acquisition.[33] The Committee also emphasized on the importance of ensuring that the resolution applicant has not contributed to such transactions in anyway.

These suggestions have been duly incorporated in the recent amendment made to the IBC. A proviso has been inserted after section 29A(g) providing that clause (g):

[32] Insolvency and Bankruptcy Code (Amendment) Act, 2018.
[33] *Id.*

> *…shall not apply if a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of the corporate debtor by the resolution applicant pursuant to a resolution plan approved under this Code or pursuant to a scheme or plan approved by a financial sector regulator or a court, and such resolution applicant has not otherwise contributed to the preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction.*

Another suggestion which has been included in the Amendment Act is the deletion of the reference to Section 43 (related to preferential transaction) in Section 45(1) which deals with undervalued transactions, as the insolvency law committee had noted it as a drafting error.

In a case decided after the insertion of the proviso to clause (g) of Section 29A by the ordinance, in *Chitra Sharma v. Union of India*,[34] the Hon'ble Supreme Court held that Jayprakash Associates Ltd. (JAL) and Jaypee Infratech Ltd. (JIL) and their promoters shall be ineligible to participate in the CIRP by virtue of the provisions of Section 29A. The Court observed that:

> *…under Clause (g), a person who has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction…has taken place and in respect of which an order has been made by the adjudicating authority under the IBC is prohibited from participating. The Court must bear in mind that Section 29 A has been enacted in the larger public interest and to facilitate effective corporate governance.*

[34] Chitra Sharma and Ors v. Union of India and Ors., 2018 SCC OnLine SC 874.

6.3. ELIGIBILITY OF RESOLUTION APPLICANTS

Initially the IBC allowed any person to be a resolution applicant and submit a resolution plan. In *Sree Metaliks Ltd. v. SREI Equipment Finance Ltd.*,[35] the NCLT has held that the Code provides no restriction on who can be a resolution applicant, and this may include a promoter of a corporate debtor. Similar observation has been made in *Sanjeev Shriya v. State Bank of India*.[36]

However, as discussed above, this position changed pursuant to the insertion of section 29A by an ordinance and subsequently the Insolvency and Bankruptcy Code (Amendment) Act, 2018. The need for this legislative intervention arose due to concerns that persons who through their misconduct had contributed to the default of companies may use this lacuna in the law to participate in the resolution or liquidation process and ultimately gain or regain control of the corporate debtor. The statement and object of the Bill as introduced in Lok Sabha notes that, "[t]his may undermine the processes laid down in the Code as the unscrupulous person would be seen to be rewarded at the expense of creditors."[37]

However, the insertion of Section 29A led to a new set of problems. Due to its 'wide' nature, the disqualifications had the potential to prevent innocent applicants from participating on technical grounds, thereby making the possibility of liquidation rather than resolution more likely.

[35] Sree Metaliks Ltd. v. SREI Equipment Finance Ltd., 2017 S.C.C. OnLine N.C.L.T. 6812.
[36] Sanjeev Shriya v. State Bank of India, (2018) 2 All L.J. 769.
[37] Insolvency & Bankruptcy Code (Amendment) Bill, 2017, *available at* http://www.prsindia.org/uploads/media/Bankruptcy/Insolvency%20and%20Bankruptcy%20Code%20Amendment%20Bill%202017.pdf.

This section laid down a complex and multi layered range of disqualifications for resolution applicants.

In *RBL Bank Ltd. v. MBL Infrastructure Ltd.*,[38] the NCLT observed that it cannot be the intention of the legislature to disqualify the promoters as a class but to rather exclude those classes of persons who may affect the credibility of the resolution process given their antecedents. The tribunal noted that "merely because there is default by a borrower in repayment of borrowed amount to a creditor does not render the borrower or its guarantor, dishonest. Every act of default cannot be equated with malfeasance."

Dealing with this issue, the Committee recognized the need to streamline the process so as to ensure that only those parties who directly contributed to the default of the company are prevented. This provision was depriving genuine persons who could aid the revival of the company from doing so. In view of the NPA situation in the country, it recommended that financial entities be allowed to participate in the resolution process.

The Amendment Act has taken this recommendation into account and fine-tuned section 29A accordingly. Moreover resolution application holding an NPA by virtue of acquiring it in the past under the IBC, 2016, has been provided with a three-year cooling-off period, from the date of such acquisition.[39] Furthermore, through an amendment in Section 30 the

[38] C.A. (I.B) No. 543/KB/2017 arising out of C.P (IB)/170/KB/2017.

[39] *President Approves Promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018*, PRESS INFO. BUREAU, http://pib.nic.in/newsite/PrintRelease.aspx?relid=179805 (last visited July 6, 2018).

onus has been placed on the applicant to prove that he is eligible to submit a resolution plan by submitting an affidavit to that effect. It also grants a one year grace period to the resolution applicant to gain all necessary statutory requirements. The Committee had recommended the deletion of the words "if such person, or any other person acting jointly or in concert with such person" in the first line of section 29A to clarify that the disqualification applied only to resolution applicant and 'connected persons'. However, this recommendation has not been incorporated in the Ordinance or the Amendment Act.

In *Insolvency & Bankruptcy Board of India v. Wig Associates Pvt. Ltd.*,[40] The NCLAT observed that the view of NCLT Mumbai bench *in Re: Wig Associates (P.) Ltd.*,[41] in holding that that the ineligibility in Section 29A does not apply to on-going insolvency proceedings 'may not be proper, but the IBBI having no *locus standi* cannot challenge the finding aforesaid.' However, the appellate tribunal left the door open for the resolution professional to file an appeal.

6.4. MICRO, SMALL & MEDIUM ENTERPRISES (MSME)

The Amendment Act has inserted Section 240 to the principal act to support the MSME sector. Section 37 of the Amendment Act lays down that clause (c) and (h) of Section 29A shall not apply to a resolution applicant in case of CIRP of a MSME. Moreover, the central government has been empowered to issue notification directing that provisions of the

[40] Company Appeal (AT) (Insolvency) No. 415 of 2018.
[41] MA No. 435 of 2018 in CP No. 1214/I & BC/NCLT/MB/MAH/2017.

Act will not apply to the sector. This amendment follows the recommendations of the Insolvency Law Committee to the same effect.

7. CONCLUSION

In a short span of two years, the Insolvency & Bankruptcy Code, 2016 has thrown open a host of legal issues. As a result, businesses, lawyers, judges, and specialized professionals have faced unique challenges. It was therefore unsurprising to witness frequent amendments being made to the Code. A large number of issues have even been dealt with by the Hon'ble Supreme Court. In the context of early resolution being one of the objectives of the new law, this was not ideal.

However, the recent report of the Insolvency Law Committee has painstakingly delved into most of the existing problems and suggested adequate reforms. While debate continues on some of them as well as their adequacy, the recent Ordinance and subsequent Amendment Act which incorporated some of the changes came at a crucial time and is sure to aid India's ease of doing business rankings. The learning curve in the field of insolvency law is not over yet, and it will take another few years for the mechanism of the Insolvency & Bankruptcy Code to fully assimilate with Indian law, until then, novel concerns will keep arising, the onus will be on NCLT, NCLAT, IBBI and the Supreme Court to resolve these as early as possible, given what is at stake for the country and the economy.