

Development of Insolvency code

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Introduction

The term insolvency in its legal sense means, "such a relative condition of a man's assets and liabilities that the former, if all made immediately available, would not be sufficient to discharge the latter." The insolvency laws in India have quite the complicated history to say the least. However, with the advent of the code, there have been unprecedented changes in the landscape of insolvency laws in India, most importantly the inclusion of the concept of 'corporate insolvency resolution process.'

Background

The Insolvency & Bankruptcy Code, 2016 (the "Code") consolidated the archaic insolvency laws, provided a consolidated legislation and revolutionised the insolvency regime in India. Undoubtedly, the Code has had a significant impact on the way corporate India functions. It has been almost two years since the Code came into effect and in the year 2017 some significant amendments have been made to the Code based on inputs received from various market participants.

The President of India while exercising his power under Article 123 of the Constitution of India on November 23, 2017 promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 ("Ordinance") which amended the existing Code. The purpose of this Ordinance was to strengthen the Corporate Insolvency Resolution Process ("CIRP").

The Insolvency and Bankruptcy Code (Amendment) Bill, 2017 was introduced to replace the Ordinance. The bill was passed by both houses of the Parliament and received President's assent on January 18, 2018 to become the Insolvency and Bankruptcy (Amendment) Act, 2018 (the "Amendment Act").

The Amendment Act has a retrospective effect as it is deemed to be in force from November 23, 2017. This also means that it nullifies the Ordinance which came into force on same day and any action which was governed by the Ordinance will be governed by the Code as amended by the Amendment Act.

Analysis of the key changes made by the Amendment Act

Qualifying criteria for resolution applicants

The Amendment Act amends the liberty provided to the resolution professional laid down in Section 25 of the Code. Previously, the resolution professional had the liberty to invite any prospective lender, investor, and any other person to put forward a resolution plan. However, the Amendment Act provides that the resolution professional must now determine eligibility criteria, with the approval of the committee of creditors, for persons who can be invited by the resolution professional for presenting the resolution plan. While determining the eligibility criteria, the resolution professional is now obligated to give due regard to the complexity and scale of operations of the business of the corporate debtor.

This amendment would ensure that only persons with sufficient and relevant financial, legal and technical competency submit the resolution plan.

Disqualification from submitting resolution plan

Prior to the Amendment Act, it was becoming increasingly common amongst the unscrupulous promoters of corporate debtors to themselves submit a resolution plan in a CIRP for their own distressed company and thereby be the resolution applicant.

In order to curb such practices, the Amendment Act has now added a new provision in form of Section 29A in the Code. This amendment is made in line with the Ordinance. However, unlike the ordinance, the Amendment Act uses the word ‘persons acting jointly or in concert’ which implies that apart from the ineligible person any other person acting together with such person for a common objective is also ineligible to be a resolution applicant.

Section 29A of the Code now makes certain persons ineligible to submit a resolution plan, if such person, or any person acting jointly with such person, is: (i) an undischarged insolvent; (ii) a wilful defaulter; (iii) a person who has an account or an account of a corporate debtor under the management or control of such person, classified as non-performing asset and a period of one year has lapsed since such classification; (iv) a person convicted of any offence punishable with imprisonment for two years or more; (v) a person disqualified to act as a director under the Companies Act, 2013; (vi) a person prohibited by the Securities and Exchange Board of India from trading in securities or accessing the capital markets; (vii) a person who has been a promoter or in the management or control of a corporate debtor in which

a preferential or undervalued or extortionate credit or fraudulent transaction has taken place in respect of which an order has been made by the National Company Law Tribunal (“NCLT”); (viii) a person who has executed an enforceable guarantee in favour of a creditor, in respect of a corporate debtor undergoing CIRP; ix) a person who has been subject to any disability, corresponding to clauses (i) to (viii) above, under any law in a jurisdiction outside India.

The Amendment Act, prohibits a person who has a ‘connected person’ suffering from any of the disqualifying factors mentioned in (i) to (ix) above also from presenting a resolution plan. The term ‘connected person’ means any person (i) who is the promoter or in the management or control of the resolution applicant; or (ii) who shall be the promoter or in management or control of the business of the corporate debtor undergoing the CIRP; or (iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii) above but not including a scheduled bank, an asset reconstruction company and an alternative investment fund.

Therefore, contrary to the popular perception, not all ‘connected persons’ are disqualified from submitting a resolution plan but only those specific ‘connected persons’ suffering from the disqualifying factors mentioned in (i) to (ix) above are disqualified from submitting a resolution plan.

As mentioned above, a person who has executed an enforceable guarantee in favor of a creditor, in respect of a corporate debtor undergoing CIRP is also not eligible to submit a resolution plan. In this regard, there was a lot of confusion whether any guarantor will be disqualified from submitting a resolution plan or only defaulting guarantors will be disqualified. Therefore, a guarantor cannot be disqualified only on the ground of existence of a binding contract of guarantee but shall stand disqualified only upon default. However, an appeal has been preferred against this order and the matter still lies undecided before the National Company Law Appellate Tribunal.

Therefore, the above mentioned disqualification factors narrow down the scope of potential suitors who will be able to submit a bid for stressed assets and the number may reduce significantly. But it is a welcome change considering it disqualifies persons having poor antecedents from taking part in the CIRP process and thereby improving its credibility. It would be mandatory for the resolution applicants to disclose all details about themselves and the persons acting in concert with them for submission of the resolution plans. This would also lead to more transparency.