THE ESSAR INSOLVENCY CASE: SUPREME COURT UNRAVELS SECTION 29A OF THE INSOLVENCY AND BANKRUPTCY CODE

1. INTRODUCTION

Earlier this month, the Supreme Court of India (the "**SC**") passed a much-awaited judgment[1] concerning the eligibility of resolution applicants for Essar Steel India Limited ("**Essar Steel**"). This article discusses the SC verdict, which not only interprets Section 29A of the Insolvency and Bankruptcy Code, 2016 (the "**Code**") in depth, but also sheds light on certain ambiguities relating to its applicability.

Section 29A was introduced in the Code to broadly prevent persons whose misconduct contributed to the default of the corporate debtor or those who were otherwise undesirable, from gaining control of the corporate debtor.

Commentators have been divided over the intent and practicality of Section 29A, in particular, in the context of the interpretational complexity inherent within it. Pursuant to the introduction of Section 29A, considerable litigation has been filed in relation to the eligibility of resolution applicants, leading to delays in the resolution process of insolvent entities, undermining the intent of the Code.

2. BACKGROUND

In this particular case, the resolution professional (the "**RP**") for Essar Steel, after analyzing the resolution plans submitted by Numetal Limited ("**Numetal**") and Arcelor Mittal India Private Limited ("**AMIL**") (collectively, the "**Resolution Applicants**"), disqualified both by declaring them to be ineligible in view of Section 29A of the Code. Following the RP's decision, in April 2018, the Ahmedabad bench of the National Company Law Tribunal (the "**NCLT**")[2] concurred with the decision to disqualify the Resolution Applicants.

One of the shareholders in the case of Numetal was Rewant Ruia whose father, Ravi Ruia was a promoter of Essar Steel (the "**Promoter**"). It was pertinent to further note that the account of Essar Steel was classified as a non-performing asset (an "**NPA**") for a period of more than 1 (one) year prior to the commencement of the insolvency resolution process of Essar Steel. Further, the Promoter had also issued a guarantee in favour of the creditors of Essar Steel. Therefore, Numetal was held ineligible in view of Section 29A (c) and Section 29A (h) of the Code.

On the other hand, AMIPL was held to be ineligible under Section 29A (c) of the Code, as ArcelorMittal Netherlands ("**AM Netherlands**") was found to have been the promoter or exercised control over two companies namely, Uttam Galva Steels Limited ("**Uttam Galva**") and KSS Petron Limited ("**KSS Petron**"),

[1] *Arcelor Mittal India Private Limited v. Satish Kumar Gupta and Ors, Civil Appeal Nos. 9402-9405 of 2018*; https://www.sci.gov.in/supremecourt/2018/33945/33945_2018_Judgement_04-Oct-2018.pdf.

[2] *Numetal Ltd. v. Satish Kumar Gupta and Ors, [2018] 209 Comp Cas 181*; https://nclt.gov.in/sites/default/files/final-orders-pdf/16.pdf.

whose accounts were classified as an NPA for more than 1 (one) year prior to the commencement of the insolvency resolution process of Essar Steel.

Contrary to the decision of the NCLT, the National Company Law Appellate Tribunal (the "**NCLAT**")[3] agreed with the disqualification of AMIPL, but came to a different conclusion regarding Numetal. This was because Rewant Ruia had by then *divested* his interest in Numetal in favour of a third party.

Thereafter, AMIPL approached the SC against the decision of the NCLAT. The SC, close to the heels of the order by NCLT, held that both the Resolution Applicants were disqualified from submitting resolution plans as the plans submitted by them were in contravention of Section 29A of the Code. However, the SC exercised its' extraordinary power under Article 142 of the Constitution of India to give the Resolution Applicants one final opportunity. They were asked to clear any outstanding dues regarding their NPA accounts within 2 (two) weeks of the SC verdict.

Certain arguments advanced on behalf of AMIPL to render it eligible, included the disposal of its' shareholding in KSS Petron and Uttam Galva, the deposit of approximately INR 7,000 crores (approximately USD 950,000,000) into an escrow account in relation to the overdue amounts of Uttam Galva and KSS Petron, declassification of AM Netherlands as the promoter of Uttam Galva, no appointed director on the board of Uttam Galva and no liability under any bank guarantees in relation to indebtedness of either entity.

On the other hand, it was argued on behalf of Numetal that it should be eligible to be a resolution applicant, since Rewant Ruia, who was deemed to be acting in concert with the Promoter, had exited Numetal *before* the submission of the second round of bids and hence, he did not fall within the ambit of 'control', 'promoter' or 'managing director', which would otherwise, disqualify Numetal from being a bidder. However, the bank guarantee issued by the Promoter in favour of one of Numetal's creditors was still valid, essentially disqualifying Numetal under section 29A(h) of the Code.

3. KEY ASPECTS ADDRESSED BY THE SC

3.1 Ingredients of Section 29A of the Code

(a) Lifting of the corporate veil

The SC invoked the principle of '*lifting the corporate veil*' to determine the ineligibility of the applicant submitting a resolution plan. After analyzing the jurisprudence on the principle of the corporate veil, the SC laid down that:

"*where a statute itself lifts the corporate veil, or where protection of public interest is of paramount importance, or where a company has been formed to evade obligations imposed by the law, the court will disregard the corporate veil. Further, this principle is applied even to group companies, so that one is able to look at the economic entity of the group as a whole.*"[4]

[3] *Numetal Limited v. Satish Kumar Gupta and Ors, Company Appeal (AT) (Insolvency) No. 169 of 2018*; https://nclat.nic.in/Useradmin/upload/8283361285b9256d604992.pdf.

[4] See para 34 of the judgement at p. 61.

Hence, applying this principle to the facts of the present case, the SC reasoned that the statute itself contained language of wider import intending to implicate all the persons who may act *arm-in-arm* with the person submitting the resolution plan.

Further, it was held that it was imperative to bring to light all the real entities or individuals who have set up such a corporate vehicle for submission of a resolution plan. Concluding, the SC negated the applicability of a well-settled principle: "*that a shareholder is a separate legal entity from the company in which he holds shares*" as enshrined in the case of *Saloman v. A. Saloman and Co. Ltd*.[5] to the facts of this case.

(b) **Management and control**

It is pertinent to note that sub-clause (c) of Section 29A contains a specific disqualification which states that a person is ineligible to bid for an insolvent company if:

"*it has an account, or is in management or control, of a corporate debtor whose account has been classified as a NPA for a period of at least one year from the date of such classification until the date of commencement of the corporate insolvency resolution process.*"

The SC stipulated that any of the three elements, namely that: (a) the corporate debtor may be under the management of the person mentioned in section 29A; or (b) under the control of such person; or (c) may be a person of whom such person is a promoter needs to be established for the applicability of Section 29A (c).

In the present case, the SC engaged in a detailed discussion regarding the element of 'control' and whether 'control' referred only to *positive* control or whether it also included the power to *block* special resolutions of a company.

In this context, the SC discussed the case of *Subhkam Ventures (I) Private Limited v. Securities and Exchange Board of India*[6], wherein the Securities Appellate Tribunal held that the expression 'control' covers *proactive* or *positive* power as opposed to a mere *reactive* or *negative* control.

Accordingly, the SC concluded that the two words 'management' and 'control' take colour from each other, based on which the principle of '*noscitur a sociis*[7]' should be applied. In view of this, it surmised that sub-clause (c) of Section 29A referred only to *positive* control, as opposed to the expansive reading of section 2(27) of the Companies Act, 2013, which may cover *negative* control as well. With respect to 'management', the SC held that the expression referred to the *de jure* management of the corporate debtor, which ordinarily vests in the board of directors of the company.

On that account, it becomes clear that a person is said to be exercising '*control*' in cases where it creates or commands a situation by taking an initiative, controls the management or policy decisions of a company or appoints a majority of the directors. On the other hand, if such person

[5] *Saloman v. A. Saloman and Co. Ltd, [1897] AC 22.*

[6] *Subhkam Ventures (I) Private Limited v. Securities and Exchange Board of India, Appeal No. 8 of 2009* decided on 15.1.2010.

[7] The phrase '*noscitur a sociis*' means that the *meaning* of questionable words or phrases in a statute may be ascertained by reference to the meaning of words or phrases associated with it.

prevents the company from doing an act, that *cannot* be regarded as exercising 'control' within the meaning of section 29A(c).

3.2 Strict compliance of timelines under the Code

The SC in the present case, relied upon its own jurisprudence laid down in *Innoventive Industries Limited v. ICICI Bank*[8] and accordingly observed that the consequence of *not* adhering to strict timelines as prescribed under the Code, was the liquidation of the corporate debtor. Further, it shed light on its' 3 principal conclusions discussed below.

First, the SC elaborated on the role and duties of the RP, laying down that the RP has no judicial authority and hence, it is not its' duty to determine the legality of bids. Its' responsibility is to form a *prima facie* opinion based on facts presented to it, ensuring that all the essentials of a resolution plan are fulfilled. Further, it noted that the RP is required to prepare a due diligence report for the Committee of Creditors (the "**CoC**") stating whether the resolution plan is in order. Hence, it concluded by observing that "*the role of the professional is only to* 'examine' *and* 'confirm' *that each resolution plan conforms to what is provided in Section 30(2)*".

Second, the SC made it explicit in the judgement that the NCLT or any other adjudicating authority *cannot* intervene until the RP finalizes its' proposals and the CoC makes a final call on the bids. Therefore, it becomes clear that no application by any resolution applicant before the adjudicating authority will be considered, until the finality of the decisions by the RP and the CoC. Further, the SC held that a writ petition filed before a High Court would also be turned down on the grounds that no right, much less a fundamental right, is affected at this stage. Consequently, it is only after the CoC discovers that a resolution plan contravenes section 29A, that the resolution applicant can challenge the order before the NCLT and thereafter, the NCLAT, which may then determine the question quasi-judicially.

Third, the SC having reasonably construed the statute, observed that litigation which involves a stay owing to a substantive issue in the corporate insolvency resolution process, ought to be excluded from the 270-day timeline as prescribed under the Code to facilitate a resolution plan. On the other hand, litigation on procedural matters, which do not necessarily stay the insolvency resolution process, need to be included in the 270-day timeline.

4 INDUSLAW VIEW

In conclusion, the SC granted AMIPL and Numetal a period of 2 (two) weeks to clear all their unpaid liabilities regarding their NPA accounts to become eligible resolution applicants.

It should be noted that AMIPL had already deposited close to INR 7,000 crores (approximately USD 950,000,000) towards its' unpaid liabilities in an overseas escrow account. On the other hand, Numetal, because of its association with Rewant Ruia, may have to pay the entire amount, due to Essar Steel and its' group companies which have previously been declared as NPAs.

Prima facie, Numetal is going to have to discharge significantly larger unpaid liabilities as compared against AMIPL. It may not be commercially viable for Numetal to clear the debts for Essar Steel *and* its' group companies; and if so, it would make them ineligible to continue as a resolution applicant. However, it is interesting (and perhaps paradoxical) to note that, if Numetal is successful in discharging the debts of Essar

[8] *Innoventive Industries Limited v. ICICI Bank, 2018 (1) SCC 407.*

Steel and its' group companies, Essar Steel will no longer be an insolvent company from the point of view of the Code, therefore negating the entire process.

On the issue of compliance with the timelines under the Code, the SC stressed:

(a) the requirement to 'resolve or liquidate' in accordance with the strict timelines prescribed under the Code;

(b) excluding time taken by the NCLT and the NCLAT for resolving disputes from the 270 days' time frame; and

(c) any challenge by a resolution applicant should arise only when the CoC puts the resolution plan down (and not when the RP forms a *prima facie* opinion).

While on the one hand, the judgment should cut out time consuming frivolous litigation, undermining the very intent of the Code, the SC appears to be caught between underlining the sanctity of the time lines for resolution and the commercial realities that will inevitably arise in a liquidation scenario.

Essentially, the role of the tribunals should be limited to questions of *law* with the commercial considerations being left to the CoC. Arguably, there is no swift resolution in sight for Essar Steel as this decision is likely to open a '*pandora's box*' irrespective of what course of action the stakeholders choose to follow.

Finally, we point out that there still remains *some* uncertainty on the interpretation of the exclusion of the time taken by the NCLT and the NCLAT in the context of the resolution period under the Code. Going by the judgment, the SC seems to have said that litigation, which does not halt the insolvency proceedings, needs to be *included* in the 270-day timeframe. However, in reaching that conclusion, the SC did not expressly overrule the order given by the NCLAT in the matter of *Quinn Logistics India Pvt. Ltd.*[9] ("**Quinn**") wherein the adjudicating authority held that the intervening period of the tribunals and the courts can be *excluded* from the resolution period.

Hence, in this aspect, we take the view that the NCLAT's order in Quinn and the SC judgement do not reconcile. Moreover, there may also be a possibility of litigation on procedural issues, which may involve a stay on the proceedings. The question, therefore, arises whether the litigation period should be excluded or not in such cases. In our view, the interpretation of 'essential litigation to be excluded' will require further clarification.

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[9] *Quinn Logistics India Pvt. Ltd., C.A. No. 93 of 2018 in CP (IB) No. 97/7/HDB/2017.*

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