INDIA'S SUPREME COURT ALLOWS DISQUALIFIED RESOLUTION APPLICANTS TO CURE INELIGIBILITY

Under India's Insolvency and Bankruptcy Code, 2016 (the "**Code**"), a potential bidder (who has been party to or caused the indebtedness and insolvency of a company) can be disqualified from bidding for and submitting a resolution plan to rehabilitate the company. The primary reason for this is to prevent such a bidder from deriving the benefits of the insolvency process, directly or indirectly, at the expense of the creditors. In fact, the issue of eligibility to be a resolution applicant has been the subject matter of several insolvency proceedings under the Code and has even mandated an amendment to the Code earlier this year.

Recently, in the long-standing insolvency resolution process of Essar Steel India Limited ("**Essar**"), India's Supreme Court (the "**SC**") reconsidered the ineligibility of ArcelorMittal India Private Limited ("**Arcelor**") and Numetal Limited ("**Numetal**"). This update discusses the SC's interpretation on the disqualification of resolution applicants under the Code.

Background

On August 2, 2017, the National Company Law Tribunal, Ahmedabad ("**NCLT**"), admitted a petition for the recovery of financial debts of INR 450 billion (approx. US$6.8 billion) owed by Essar. Arcelor and Numetal submitted their resolution plans on February 12, 2018, and on March 23, 2018, the resolution professional ("**RP**") found both Arcelor and Numetal to be ineligible to apply as resolution applicants under the Code.

Arcelor's ineligibility under the Code

Arcelor was found to be ineligible to bid for Essar as until a few days before submission of the resolution plan, Arcleor was the indirect parent of Uttam Galva Steels Limited ("**Uttam**"), which was declared to be a non-performing account in March 2016. Based on this, the RP considered Essar to be connected with Uttam, a corporate debtor. Further, the RP noted that Arcelor was an admitted connected party of KSS Global BV, the promoter of KSS Petron Private Limited ("**KSS**"), classified as a non-performing account and a corporate debtor under the Code. It must be noted that a week before submission of the resolution plan, Arcelor sought to cure its ineligibility by offering to sell its indirect shareholding in Uttam and KSS Global BV, and three (3) days before submitting the resolution plan, Arcelor actually sold its indirect shareholding in Uttam and KSS at a nominal price.

Numetal's ineligibility under the Code

Numetal was found to be ineligible to bid for Essar as Mr. Rewant Ruia (the son of a promoter of Essar) was the sole ultimate owner of Aurora Enterprises Limited ("**Aurora**") which held a 73.9% stake in Numetal. Although Numetal attempted to cure this ineligibility by reducing the stake of Aurora in Numetal to 25% so as to not be considered in control of Numetal, the RP held that Numetal was ineligible on the date of submission of the resolution plan. However, during the pendency of the proceedings before the NCLT, Aurora completely divested its stake in Numetal to the remaining shareholders and Numetal submitted a revised resolution plan.

Order of the NCLT and the National Company Law Appellate Tribunal

The NCLT agreed with the RP's stance on the ineligibility of both, Arcelor and Numetal, to submit a bid for Essar. In appeal, the National Company Law Appellate Tribunal ("**NCLAT**") also agreed on the stand taken by the NCLT on the ineligibility of Arcelor, and maintained that Arcelor would continue to be ineligible until the debts owed by Uttam and KSS were repaid. However, the NCLAT held that Numetal had cured its ineligibility as Aurora had ceased to be its owner. Arcelor filed an appeal before the SC from the order of the NCLAT and prayed that the SC declare Arcelor as an eligible resolution applicant and Numetal as an ineligible resolution applicant.

Decision of the SC

Based on the facts and a reading of the disqualification grounds under the Code, the SC concluded that both, Arcelor and Numetal, were ineligible to submit a resolution plan. The key reasons for the SC's ruling are as follows.

- The SC observed that the Code stipulates disjunctive requirements to ascertain the ineligibility of a resolution applicant. In the SC's view, ineligibility is established if any one (1) of the three (3) requirements is established, i.e., the resolution applicant, or a person connected with resolution applicant, manages or controls or is a promoter of a corporate debtor having an account that has been classified as a non-performing asset.

- The SC held that management refers to a *de jure* management, and therefore, refers to management by the board of directors and other key managerial personnel, including management by a manager, a managing director or an officer of the corporate debtor.

- Further, the SC interpreted the word "control" to refer to both, *de jure* control as well as *de facto* In the SC's view, exercising *de jure* control includes possessing the legal right to appoint a majority of the directors of the company. On the other hand, the SC observed that exercising *de facto* control refers to exerting any kind of positive influence on the management (day-to-day management) or policy (long-term strategy) decisions of the company in any manner whatsoever.

- The SC also observed that the Code refers to a corporate debtor that is "under" the management or control of such person. In the SC's view, the use of the word "under" implied that the control exercised by a person must necessarily be a form of positive or proactive control.

- With respect to the third requirement, the SC interpreted that a "promoter" will have the meaning specified under the Companies Act, 2013, which provides for a *de jure* promoter and refers to a person factually recognized as a promoter in the prospectus or annual return of a company. On the other hand, the Code mentions a *de facto* promoter and refers to any person who may exercise control over the affairs of a company in the nature of a promoter. Therefore, on a combined reading, the SC observed that a promoter under the Code may be a *de jure* or *de facto* promoter.

- The SC noted that Arcelor sold its indirect stake in Uttam and KSS at a nominal value of INR 1 (approx. US$0.014) per share immediately prior to the submission of the resolution plan. The SC viewed these sale transactions as a clean-up act in order for Arcelor to meet the requirements under the Code and be eligible to bid for Essar. Instead of divestment of the stake, if Arcelor had infused funds to clear the outstanding debt of Uttam and KSS it would have been compliant with the provisions on curing of ineligibility under the Code as well. It must be noted that clearing the outstanding debts of a connected corporate debtor is the only mechanism to cure ineligibility under the Code.

- On Numetal's ineligibility, the SC observed that the Code allowed the lifting of the corporate veil to identify the actual applicants of a resolution plan. Based on this principle, the SC concluded that the involvement of the Ruia family in Numetal continued even after Aurora ceased to be a shareholder. The primary reason for this view was that the amount of INR 5 billion (approx. US$67 million) deposited by Numetal along with its resolution bid was funded by Aurora, and Aurora did not seek to revoke this deposit despite ceasing to be a shareholder of Numetal. Therefore, the SC held that Numetal was ineligible as its connection with the Ruia family continued.

Despite holding both resolution applicants to be ineligible, the SC granted two (2) weeks to clear their outstanding debts and cure their ineligibility. The SC justified this view on the basis that the Code was drafted with the objective of resolution of insolvency over liquidation and must be interpreted with due commercial sense. Therefore, the SC held that it was obliged to give the resolution applicants every opportunity to cure their ineligibility in order for the insolvency to be resolved.

Our Comments

This ruling was the SC's first interpretation of the disqualification grounds for a resolution applicant under the Code and is likely to be a landmark one. In this judgment, the SC has comprehensively analyzed the meaning of the various terms used in the relevant provisions of the Code and has laid down a strong precedent for future judicial decisions on this aspect of the Code.

However, in our view, the SC has also created confusion in interpreting the timelines stipulated for various actions under the Code. For instance, it held Arcelor to be ineligible despite the fact the Code expressly requires an applicant to be eligible on the date of submission of the resolution plan and makes no mention of any inquiry into an applicant's actions before the foregoing date. The SC's interpretation in this regard is likely to result in the inquiry of every resolution applicant's actions before the date of submission of the resolution plan in respect of future resolution processes, which is beyond the express mandate of the Code.

Further, despite noting that the Code emphasizes on the need for a resolution process to be completed within a period of two hundred and seventy (270) days from the date of initiation, the SC granted a further extension to Arcelor and Numetal to cure their ineligibilities. As a result, the SC has significantly diluted the strict timeline which forms a basic tenet of the Code and differentiates it from India's past debt recovery laws. The foregoing issues indicate the SC's view on the timelines prescribed under the Code is

not consistent with the express mandate of the legislature, and therefore, is not good for creditor confidence. We hope that the SC clarifies its stance on the timelines under the Code for the benefit of both, creditors as well as corporate debtors.

As far as the insolvency process of Essar goes, recently the promoter Ruia-family has made a last minute offer to pay all outstanding dues to Essar's creditors and retain control of Essar. It will be interesting to understand if the Code can be interpreted to allow bids like this by the promoter family more so because (if accepted by the creditors) it will scuttle the entire process which has been ongoing since a long time.