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ISSN: 2582-6433

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ISSN: 2582-6433

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ISSN: 2582-6433

Disqualification From Submitting Resolution Plan *Vis-A-Vis* Defaulting Personal Guarantors

Authored By - Abhinav Gaur, Advocate

With the advent of the last decade, India has seen a paradigm shift in the regulatory regime of its domestic corporate laws for betterment in terms of ease of doing business besides gaining the trust of investors in India. Corporate laws in India were often referred to as outdated and inflexible laws which left little room for change with the ever evolving global corporate structures and laws being enacted worldwide to address the issues governing the corporate space. One of such issues which is the point of discussion in this article is the issue of insolvency and bankruptcy vis-a-vis ineligibility or disqualification of certain class of persons from participating in the corporate insolvency resolution process. In this article the author discusses the disqualification criteria introduced by amending Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "**IBC"**) and inserting Section 29A(h) which restrains defaulting personal guarantors from submitting resolution plan with an intention to preserve the sanctity of the corporate insolvency process and also safeguarding the interest of the genuine creditors in the corporate debtor. The Hon'ble Supreme Court of India in the case of Bank of Baroda vs. MBL Infrastructures Private Limited in its verdict dated 18 January 2022 has clarified the ambiguity surrounding the aspect of applicability of the said disqualification on such resolution plans which have already been acted upon or are under consideration by the committee of creditors.

The said change in corporate law regime in India began with repealing of the Companies Act, 1956 and its replacement with an entirely new enactment of law be in Companies Act, 2013 and soon thereafter, the enactment of IBC. IBC was brought into effect in phase by phase manner from 1 December 2016 and it is a one of its kind statute enacted to consolidate and amend the laws regarding insolvency resolution of *inter-alia* corporate persons in a time bound manner to maximise asset value and balance the interest of all the stakeholders. With the introduction of Section 29A of IBC certain ambiguity had arisen in respect of its application to

ISSN: 2582-6433

the pending resolution plans submitted by defaulting personal guarantors which has now been settled by the Apex Court which has been discussed in detail in this article.

Introduction & Synopsis of IBC

The IBC comprises of four parts where the first part deals with preliminary provisions regarding application of the Code and general definitions; the second parts deals with insolvency resolution and liquidation process of corporate persons; the third part deals with insolvency resolution and bankruptcy of individuals and partnership firms and lastly the fourth part deals with regulation of insolvency professionals, agencies, information utility and incorporation of Insolvency and Bankruptcy Board of India (**IBBI**).

For the purposes of this article, we will be discussing the second part of IBC and more particularly Section 29A which deals with the provisions relating to ineligibility of certain persons from submitting resolution plans and otherwise participating in Corporate Insolvency Resolution Process (**CIRP**) of the corporate debtor. Before discussing the said provision of Section 29A of IBC, it may be pertinent to understand the scheme of the second part of the IBC which is spread into seven chapters from Section 4 to Section 77.

Chapter 1 comprises Section 4 and 5 dealing with application of the second part of IBC and definitions applicable to the terms referred in the said part respectively. Section 4 prescribes for minimum amount of default to make a person eligible to file an application under the second part against a corporate debtor at Rs. 1 lac which has now been increased to Rs. 1 crore by the Central Government vide a notification dated 24.03.2020. The said increase in threshold was introduced in order to prevent invocation of CIRP at such a low threshold of default of Rs. 1 lac, since the Ministry of Home Affairs had issued a nation-wide lockdown owing to onset of Covid-19 pandemic and the companies were beginning to experience financial distress due to the same. Section 5 on the other hand prescribes for definition of various terms used in the second part of IBC, few of which being relevant for this article are also being discussed here for ease of understanding. Section 5(5) of IBC defines "**Corporate Applicant**" as a corporate debtor, or a member thereof who has been authorized to make an application for CIRP, or an individual who is in charge of managing the operations thereof, or otherwise having control and supervision over its financial affairs. The term "Corporate Debtor" has been defined under Section 3(8) of IBC to mean a corporate person who owes a debt.

Chapter 2 comprises Sections 6 to 32 in which Section 6 provides that in case of a default by a

ISSN: 2582-6433

corporate debtor, a financial creditor, operation creditor or the corporate applicant may initiate CIRP. Section 7 provides for procedure for initiation of CIRP by a financial creditor, Section 9 provides for procedure for initiation of CIRP by an operational creditor and Section 10 provides for procedure for initiation of CIRP by corporate applicant. Once the said applications are admitted by the Adjudicating Authority they culminate into passing of an order by the Adjudicating Authority under Section 13 of IBC which requires for declaration of a moratorium, making of public announcement about the initiation of CIRP, calling of claims from public at large and appointment of interim resolution professional **(IRP)** to carry out the functions prescribed under IBC. Section 12 prescribes for mandatory time limit of 330 days within which the CIRP should be completed leading to either approval of resolution plan by the Adjudicating Authority under Section 31 of IBC or passing of an order for liquidation of corporate debtor under Section 33 of IBC, as the case may be.

During the aforesaid period of operation of moratorium, the committee of creditors **(COC)** is formulated by the IRP or resolution professionals **(RP)** as the case may be which is governed by Section 21 of IBC. IRP is required to collate all the claims received from the public against the corporate debtor and on the basis of determination of financial situation of the corporate debtor, he is acquired to constitute COC. The COC comprises financial creditors of the corporate debtor, except such financial creditor which is a related party of a corporate debtor. All decisions of the COC are taken by a vote of at least 51% unless otherwise specifically provided under the Code. Section 25(2)(h) of IBC provides that the RP should call for prospective resolution applicants to submit a resolution plan from eligible resolution applicants who meet the criteria fixed by RP with approval of COC. Such criteria may be fixed with the wisdom of the COC after duly considering the complexity and scale of business operations and structure of the corporate debtor. In so far as eligibility criteria fixed by the RP and COC is concerned, the same is subject to the eligibility criteria as may be fixed by IBBI. IBBI has prescribed disqualification criteria of a person from being "Resolution Applicant" and submitting a resolution plan and also from participating in CIRP. The said disqualification has been prescribed under Section 29A of IBC which is a subject matter of discussion in this article. Before proceeding with discussion on the said provision it may be worthwhile to note that the RP is required to present all resolutions plans before COC for heir approval[1] which is required

[1] Section 25 (2)(i) of IBC.

ISSN: 2582-6433

to be approved by COC by a vote of at least 66% of voting share of financial creditors[2]. Thereafter, the approved resolution plan is required to be submitted by RP before the Adjudicating Authority[3].

Now, having briefly discussed the general provisions regarding invocation of CIRP and business during CIRP including constitution of COC and approval of resolution plan, this article will discuss the need of introducing Section 29A of IBC by way of amendment, extent of applicability of the said amendment and purpose achieved by the same. This article will also discuss pre and post amendment regime of IBC with supporting judicial pronouncements on the subject.

Object of Section 29A of IBC

Late Sri Arun Jately, the then Hon'ble Minister of Finance as well as Minister of Corporate Affairs presented the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 on 29 December 2017 and emphasized on the importance of the ordinance by stating that the statutory disqualifications being introduced would lay out the ineligibility criteria for resolution applicants as the same was missing from the IBC and with the amendment a specific carved out will be made for persons meeting the said disqualification to protect the interest of stakeholders. The said ordinance dated 29 December 2017 was further amended to include certain provisions and later became an Act on 06.06.2018.

Section 29A imposed restrictions on certain class of individuals from being resolution applicants with an intention from respecting certain class of persons from submitting resolution plans in order to ensure preservation and maintenance of faith and credibility of CIRP and further to ensure that such persons are not rewarded from CIRP at the cost of the genuine creditors. The amendment was introduced to ensure that no fraudulent promoters or directors sitting behind a coloured corporate veil take undue advantage of CIRP by gaining ultimate control of a corporate debtor which is already undergoing a financial distress. It can also be said that the said amendment was introduced to make sure that certain persons which may be said to be responsible for insolvency of corporate debtors do not reap undue benefit from the CIRP which justifies the disqualification introduced by the amendment.[4]

[2] Section 30(4) of IBC.
[3] Section 30(6) of IBC.
[4] Chitra Sharma v. Union of India, [2018] (9) SCALE 490 (SC).

ISSN: 2582-6433

Before the amendment was introduced it was a major concerned being highlighted by the corporate and insolvency law practitioner that persons whose misconduct and failure to act in the interest of the corporate debtor had driven the corporate debtor to insolvency were taking undue advantage of CIRP and without them being disqualified from participating in CIRP, the intention of the legislature was being frustrated and rendered nugatory. It appeared as if IBC was toothless without provisions like Section 29A being introduced in IBC. It was in this background that the said amendment was introduced providing for a specific list of persons who were disqualified to be resolution applicants. The amendment fixed a major loophole in the IBC taking advantage of which backdoor entry was being taken by the management of the corporate debtor which was ousted with the initiation of CIRP.

Understanding Section 29A

Section 29A of IBC was made effective from 23 November 2017 and was made applicable on pending proceedings prospectively. Though there was much hue and cry as regards its applicability being also on such resolution plans which were pending consideration before the COC or which were already approved by the COC but pending sanction of the Adjudicating Authority, it was settled by judicial pronouncement in the matter of *In Re Wig Associates (P) Ltd.*[5] by National Company Law Tribunal, Mumbai that its application was strictly prospective in nature. It was observed by the Hon'ble Tribunal that the insolvency proceedings were time sensitive and continuous in nature which cannot be halted or disturbed by the change of law unless so specifically provided for in the amended provision. As such all the pending insolvency proceedings were directed to continue taking into consideration the *status quo ante*. Thus, its applicability was only on such CIRPs which got initiated after the date of bringing into effect of the Section 29A i.e. 23 November 2017.[6]

Section 29A from the very wordings of it is a disqualification clause providing that a person will be disqualified from submitting a resolution plan if such person(s) either independently or jointly or acts in concert with other person falling within the category of persons described from sub clause (a) to (f) of Section 29A. Section 29A(a) disqualifies an undischarged insolvent from being a resolution applicant. The said term "undischarged insolvent" has not been defined in IBC, however, the term "undischarged bankrupt" has been defined under Section 79(22) of

[5] [2018] 145 CLA 255.
[6] Numetal v. Satish Kumar Gupta, [2018] 209 Comp Cas 181.

ISSN: 2582-6433

IBC to mean a bankrupt who has not received a discharged order under Section 138. Thus drawing a corollary from the same it can be said that term "undischarged insolvent" refers to individuals adjudged as insolvent under the Presidency Towns Insolvency Act, 1909 or the Provincial Insolvency Act, 1920 and continue to be undischarged under the said enactments.

Section 29A(b) disqualifies a wilful defaulter from submitting a resolution plan who has been declared by the Reserve Bank of India to be a wilful defaulter as per the extant guidelines and Banking Regulations Act, 1949. Section 29A(c) at the outset disqualifies such person(s) from submitting a resolution plan who himself or in concert with other person manages or controls or be a promoter of a corporate debtor classified as a non-performing asset if its debts are not paid at least one year prior to the commencement of CIRP. However, there are certain qualifying proviso to the said disqualification such as the first proviso provides that the said ineligibility may be cured if such person clears the entire dues including the interest and charges before submitting the resolution plan. Therefore, if a such resolution applicant is able to repay the entire outstanding before submitting a resolution plan then in that case despite such resolution applicant by itself or in concert with another person being in control of corporate debtor classified as non-performing asset in last one year period, may become eligible to submit a resolution plan[7]. What is interesting to note is that while sub-clause (a) as aforesaid refers to a *de jure* position, sub-clause (b) and (c) are *de facto* in nature insofar as this position needs to be proved factually.

Further, Section 29A(d) provides for disqualification of individuals who have been convicted with an imprisonment of two or more years under certain laws enlisted under the twelfth schedule of IBC or for seven years or more under any other law. This provision does not apply to juristic entities but only to individual resolution applicants. Sub-clause (e) disqualifies an individual who has been disqualified to act as a director under the Companies Act, 2013 and sub-clause (f) disqualifies such persons to submit a resolution plan who have been prohibited by the Securities and Exchange Board of India from trading in securities or accessing the market. The aforesaid provisions carves out ineligibility on such individuals based on their antecedent activities and have been provided to ensure that a sincere resolution applicant is given a go-ahead while those with colored history are discouraged from participating in CIRP. This also aims at promoting fair businesses and individuals who have been law abiding persons

[7] Arcelormittal India Pvt. Ltd. v. Satish Kumar Gupta, 2018 SCC Online SC 1733.

ISSN: 2582-6433

and are less likely to take undue advantage of the CIRP.

Sub-clause (g) ousts such persons who have been a promoter or in control or management of a corporate debtor in respect of which the Adjudicating Authority has passed an order of a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction. The only exception to this is if such transactions were carried out prior to the acquisition of such corporate debtor and such person has not contributed to the said transactions.

Sub-clause (h) is one provision controversy in relation to which has recently been settled by the Hon'ble Supreme Court of India. This provision provides that in case a person has executed a guarantee in favor of a creditor relating to a corporate debtor undergoing CIRP at the instance of such creditor and the said guarantees has been invoked and remains unsatisfied, then such person will also be disqualified from submitting a resolution plan.[8] Before discussing this provision in detail, it may be worthwhile to also take note of sub-clause (i) which makes a person being subject to any disability under any other law applicable outside India ineligible to submit a resolution plan and sub-clause (j) is a blanket clause which disqualifies a resolution applicant from submitting a resolution plan who has a connected person being ineligible under sub-clause (a) to (i). Connected person has been defined to mean any person who is the promoter or in the management or control of resolution applicant, or be in the aforesaid capacity when resolution plan is implemented. Holding company, subsidiary or associate company or a related party is also taken within the ambit of the definition of connected person.

Interpretation of Section 29A(h) of IBC

The Hon'ble Supreme Court of India in the case of Bank of Baroda v. MBL Infrastructures (*supra*) on 18 January 2022 gave a verdict on the interpretation of Section 29A(h) of IBC which has finally settled the position of law in this regard. This article discusses the same and analyses the position clarified by the Apex Court.

Relevant facts of the case

[8] Bank of Baroda v. MBL Infrastructures Limited & Others, CA No. 8411 of 2019 decided by Supreme Court of India on 18 January 2022.

ISSN: 2582-6433

M/s MBL Infrastructure Limited (**MBL**) was set up by Mr. Anjanee Lakhotiya (**Lakhotiya**) in early 1990s and the said company obtained various credit facilities and loans from a consortium of banks. However, MBL defaulted in repaying the loans and some of the banks invoked personal guarantees extended by Lakhotiya for the credit facilities availed by MBL. RBL Bank invoked proceedings under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 followed by other banks against MBL in the year 2013. On the footing of the aforesaid, RBL moved an application under Section 7 of the IBC before the NCLT, Kolkata against MBL which was admitted vide an order dated 30.03.2017 and an IRP was appointed.

In the aforesaid proceedings, two resolution plans were received by the RP of MBL, one of which was submitted by Lakhotiya on 29.06.2017. This resolution plan was submitted prior to the introduction of Section 29A of IBC. On 18.11.2017, the COC of MBL required Lakhotiya to submit an amended resolution plan which was accordingly submitted on 22.11.2017. Thereafter, Section 29A was introduced by way of Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 and the COC in its meeting dated 1.12.2017 decided to deliberate on the impact of the said amendment as regards the eligibility of Lakotiya to submit a resolution plan. However, due to lack of consensus in the COC it was decided by MBL to move an application before the NCLT to seek clarification in this regard.

Vide an order dated 18.12.2017, the NCLT held that Lakhotiya was eligible to submit the resolution plan despite the fact his personal guarantees were invoked by some creditors of MBL. However, this fact was never placed on record before the NCLT and as such no findings were returned in this regard while considering Section 29A(c). It was observed that since the said personal guarantees were not invoked, mere extension of personal guarantee by itself would not disqualify Lakhotiya from submitting its resolution plan for MBL under Section 29A(h). It was further observed that debt payable by Lakhotiya had not crystallised as such he could not be considered as a defaulter and with these observations, application of Lakhotiya was allowed and he was permitted to submit his resolution plan.

Assailing the said order, Punjab National Bank preferred an appeal before the National Company Law Appellate Tribunal in Company Appeal (AT) (Insolvency) No. 330 of 2017 on which vide an order dated 21.12.2017 the COC and RP were allowed to consider the resolution plan of Lakhotiya, however, the same was made subject to final outcome of the appeal and

ISSN: 2582-6433

NCLT was also directed to not accept or reject the same without prior approval of the NCLAT. On the same day, the resolution plan of Lakhotiya was put to vote before COC and it received 68.50% votes. Similarly, the order dated 18.12.2017 was challenged before NCLAT by RBL and a similar order was passed by NCLAT on 11.01.2018. Later, few other creditors also voted in favor of the said resolution plan and as such the voting share stood at 78.50%.

In the meanwhile, Section 21A(h) also came into effect from 18.01.2018 and on 23.03.2018 the NCLAT permitted Punjab National Bank to withdraw its appeal and also discharged the interim order passed by it. Later, the pending appeal was also withdrawn on 27.02.2018. With the said order, the interlocutory application filed by the Bank of Baroda to be impleaded as a party to the said appeal was also not considered and the same stood rejected with the passing of the dismissal order dated 23.03.2018. Eventually, vide an order dated 18.04.2018 NCLT Kolkata approved the resolution plan submitted by Lakhotiya.

Aggrieved by the passing of order dated 18.04.2018, the Bank of Baroda preferred an appeal before NCLAT and the same was upheld with some amendments to the resolution plan of Lakhotiya. In the meanwhile Section 29A(h) underwent further change as it stands today and the same is being reproduced below:

> *"Section 29 A- Persons not eligible to be resolution applicant – A person shall not be eligible to submit a resolution plan, if such person or any other person acting jointly or in concert with such person – xxx xxx xxx (h) has executed a guarantee in favour of a creditor, in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this code and such guarantee has been invoked by the credit and remains unpaid if full or part."*

The reasoning supplied by the NCLAT while upholding the approval of the said resolution plan was that the same was approved with 78.50% votes by COC and that it was backed by the techno-economic report. Challenging the same, an appeal was filed before the Hon'ble Supreme Court of India.

Observations of the Hon'ble Supreme Court of India vis-a-vis Section 29A

ISSN: 2582-6433

The Hon'ble Apex Court appreciated that the purpose of Section 29A is to keep a check on unwarranted and unscrupulous elements to use the CIRP with ulterior motives for their personal interest. Much importance has been ascribed to the credence of the corporate applicants while justifying the legislative intent of disqualifying certain class of persons. The Apex Court referred to the legislative history and intent of the said provision to support its findings and also referred to other judicial pronouncements of the Court while dealing with challenges to the other provisions of the IBC. It was observed that the intended disqualification under the provision was to attain sustainable revival and to make sure that the persons who are cause of the problem either by design or default are not made part of CIRP which is the solution to such problem.

It was held that the term "such creditor" in Section 29A(h) of IBC should be interpreted to mean all similarly placed creditors after admission of the application for CIRP. Resultantly, in order to be disqualified under the said provision, just a presence of personal guarantee being invoked by any creditor, whether the application has been filed by such creditor or not, would suffice. This remains subject to further compliance of the said guarantee by any other creditor. It was clarified that the ineligibility is only with respect to the participation in CIRP and that the exclusion is only meant to facilitate a fair and transparent process of CIRP.

Another issue decided by the Hon'ble Apex Court was regarding the date to be considered for applying the said provision on pending resolution plans - whether the date of submission of resolution plan or date of adjudication by the authority. It was held that considering the object intended to be achieved by the legislature, mere filing of a resolution plan would not make a resolution applicant eligible if such resolution applicant is rendered disqualified during the pendency of decision on his resolution plan.

With the aforesaid observations, the Hon'ble Apex Court held that the resolution plan submitted by Lakhotoya should have been rejected at the very outset in view of the amendment carried out in Section 29A of the IBC. However, despite noting the said illegality in entertaining the said resolution plan, the Hon'ble Court took note of the fact that much water had flown under the bridge as an amount of Rs. 63 crores was infused in MBL to make it functional and also statutory compliance with respect to voting of COC was achieved, as such in such peculiar facts the resolution plan of Lakhotiya was allowed to be implemented.

ISSN: 2582-6433

Conclusion

The Hon'ble Supreme Court has for now settled the position that if a guarantee has been extended in favor of a corporate debtor against whom CIRP has been initiated and if such guarantee has been invoked by a creditor, then in such event the guarantor is ineligible to submit a resolution plan under section 29A(h) of IBC. The trigger event for application of disqualification under the said provision is 'invocation of personal guarantee' by any single creditor even if the application for CIRP has been filed by any other creditor. The manner of invocation of the personal guarantee is of no relevance for the purpose of determining eligibility.

What is to be seen is the implication of the exception carved out by the Hon'ble Apex Court that despite the resolution plan being illegal and *de hors* the provision of Section 29A(h) of IBC, yet the said plan was permitted to be implemented considering that by the time the matter could be finally decided, much water had flown under the bridge.