ISSN: 2582-6433

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

Open Access, Refereed JournalMulti Disciplinary
Peer Reviewed6th Edition

VOLUME 2 ISSUE 7

www.ijlra.com

 ISSN: 2582-6433

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 ISSN: 2582-6433

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 ISSN: 2582-6433

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Analysis of the role of Committee of Creditors in IBC in the light of the latest Supreme Court Judgments.

Authored By- Rajnandini

1. Need of Enactment of IBC, 2016

- The Insolvency and Bankruptcy Code, 2016 was enacted to remedy the serious flaws in India's existing staggered insolvency laws and unite them under one umbrella. The code has made a significant impact on India's insolvency and bankruptcy laws. The primary goals of this code are to maximize the value of a corporate person's assets, to improve the condition of a company in financial distress, to check and control fraud committed by a corporate person who has been defaulting on payments, by establishing the Insolvency and Bankruptcy Board of India. It has resulted in improved debtors' discipline, a doubling of recovery amounts, and a reduction in the country's nonperforming assets (NPAs). Understanding the need that occurred so as to create a separatecode to deal with insolvency i.e. code of IBC is as explained below:

1. On the topic of "which act has precedence over the other?" the RDDBFI Act, the SICA Act, and the SARFAESI Act were found tobe in a power struggle.
2. Multiple statutes giving birth to diverse intersecting rights and duties, as well as multiple adjudication forums that may or may not have legal knowledge in insolvency and bankruptcy, are the reasons for this.
3. There were numerous statutes covering various areas of debt or insolvency resolution prior to the IBC's enactment namely, Sick I0ndustrial Companies (special provision) Act, 1985 ("SICA"), The Companies (Second Amendment), Act 2002, Recovery of Debts due to Banks and financial institutions Act, 1993 ("RDDBFI Act"), The Securitization and Reconstruction of Financial Assets and enforcement of the Security Interest Act, 2002 (SARFAESI Act)

4. Therefore, the necessity for a consolidated and sound bankruptcy legislation arose from the fragmented statutes, conflicts of jurisdiction, and unusual timelines.

2. Committee Of Creditors

- The Code focuses on providing relief to the creditors of the company(financial as well as operational creditors), and stakeholders. The creditors who are members of the Committee of Creditors are given priority in the Corporate Insolvency Resolution Process, and the resolution plan of a firmis carried out on the guidance of the creditors who are members of the Committee of Creditors. Under the Insolvency and Bankruptcy Code, any financial creditor or operational creditor can commence a corporate insolvency action against a corporate debtor when the corporate debtor commits a default in debt repayment.
- This committee of creditors is the final decision-making body in theCorporate Insolvency Resolution Process, and its decision will have an impact on the corporate debtor's insolvency resolution.
- Under chapter II Corporate Insolvency Resolution Process, section 21 of IBC, 2016 clearly states the composition of committee of creditors. Under section 21(2):
  "*(2) The committee of creditors shall comprise all financial creditors of the corporate debtor…….*"
  That is the committee of creditors comprises of financial creditors of the corporate debtors and not operational creditors. That the Committee of Creditors includes all creditors who have financed the corporate debtor onthe basis of time value of money. If there are no financial creditors, the COC will be made up of the eighteen largest operational creditors, as well as one representative from each of the workers and employees. The operational creditors are interested in the recovery of debt but not in the resolution of insolvency of the corporate person as like of financial creditors, this is the reason to exclude the operational creditors from beingthe member of the committee of creditors. However, if the operational creditors owe more than 10% of the total debt, the COC will be attended by a representative of the operational creditors.

ISSN: 2582-6433

- Further the proviso of section 21(2) states:

  "*provided that a financial creditor or the authorized representative ofthe financial creditor referred to in sub-section 6 or sub –section (6A)orsub-section 5 of section 24, if it a related party of the corporate debtor, shall not have any right of representation, participation or voting in ameeting of the committee of creditors…*"

That the pertinent issue in the code is that Section 21(2) provides the CoC shall comprise all financial creditors. However, if a financial creditor is a related party of the corporate debtor, the proviso to Section 21(2) says, inter alia, that a financial creditor shall not have the right of representation, participation, or voting in a CoC meeting.

This pertinent issue was decided by the Supreme Court of Indiain **Phoenix Arc Private Limited v. Spade Financial Services Limited.** The Court relied on the purposive reading of the proviso to get over this problem rather than literal interpretation of the proviso. And stated that the exclusion under the first provision of Section 21(2) of the Code is not only related to the debt but also the existing relationship between a related party financial creditor and the corporate debtor. It is important to observethat the default rule states that only those financial creditors that are the related parties in the present would be disqualified from being included inthe CoC. In the facts of this case, the relationship between the parties did not attract the prohibition as mentioned in the provision but the Court affirmed the decision of the NCLAT wherein it excluded financial creditorsfrom the CoC due to their unfair means to enter the CoC. As a result, the first proviso to Section 21(2) will apply if the related party financial creditor divests itself of its shares or ceases to be a related party in a commercial capacity with the sole goal of participating in the CoC and sabotaging the CIRP.

3. Analysis Of The Role Of Committee Of Creditors

- The company's important decisions are made with the permission of the committee of creditors. It is evidenced by the following provisions:

a. After debate on any item scheduled for voting, the Resolution professional shall take a vote of the members of the committeepresent in the meeting under Regulation 25 (3).

b. The Resolution professional shall announce the decision taken on items, along with the names of the members of the committee who voted for or against the decision, or

ISSN: 2582-6433

abstained from voting, at the completion of a vote at the meeting, as required by Regulation 25(4).

c. As per Regulation 26(4) which provides that the Resolution Professional at the conclusion of a vote held under the regulation, the resolution professional shall announce and make a written record of the summary of the decision taken on a relevant agenda item along with the names of the members of the committee who voted for or against the decision or abstained from voting.

- The Committee of creditors (COC) are placed at a influential position by the code in the Resolution process as unless all the members of the Committee are present, the voting cannot be conducted to start the Insolvency Resolution Process. On reading of the two Regulations referred above, it seems that in IBC – there are effectively two quorum – (a) 33 % of the total voting rights of the CoC – for the meeting to hold good for discussion; (b) 100 % of the total members of the CoC – for allowing voting at the meeting.
  This rule prescribed in Insolvency and Bankruptcy Code, 2016 is quiet contrary to the rules prescribed in Companies Act 2013**.** That as per Companies Act, 2013 if the minimum quorum is present, discussion can takes place and voting can be conducted.
- The interim resolution professional is confirmed as a resolution professional by the committee of creditor n s (COC), or the insolvency professional can be replaced as a resolution professional.
- The committee of creditors (COC) meets on a regular basis to debate the rules governing the operation of the interim resolution expert and to assess the corporate debtor's fate.
- By refusing to approve any resolution plan, the committee of creditors hasthe authority to proceed with the liquidation of the corporate Debtor.

ISSN: 2582-6433

3.1 Commercial Wisdom Of The COC Elaborated In The Case Essar Steel India Limited Committee Of Creditors Vs. Satish Kumar Gupta

(2020) 8 Supreme Court Cases 531

- That the role of the Committee of Creditors is limited to considering the feasibility and viability of the resolution plan, which does not include the manner of distribution of the amount payable by the resolution Applicant to the erstwhile creditors of the corporate debtor. In any event, the decision of the Committee of Creditors on the manner of distribution in the facts ofthis case is illegal and arbitrary, as once a creditor is classified as a financial creditor, such creditor is entitled to equal treatment with all other financial creditors, irrespective of whether it is secured or unsecured. The Supreme Court observed in relation to the role of the Committee of Creditors in the Corporate Resolution Process that:

  "31. Since it is the commercial wisdom of the Committee of Creditors that is to decide on whether or not to rehabilitate the corporate debtorby means of acceptance of a particular resolution plan, the provisions of the Code and the Regulations outline in detail the importance of setting up of such Committee, and leaving decisions to be made by the requisite majority of the members of the aforesaid Committee inits discretion "

3.2 K. Sashidhar V. Indian Overseas Bank

MANU/SC/0189/2019

- The court had made it clear in this case that there is a judicial hands-off when it comes to the commercial wisdom of the Committee of Creditors, which has been directly infracted by the impugned judgment, which has held that the Committee of Creditors has nothing to do with the distribution of amounts which are infused by the resolution Applicant for payment of the corporate debtor's erstwhile debts.
- Therefore, the Committee of creditors in IBC have been empowered with complete control over the operation of the corporate debtor, with the right to make major decisions and negotiate resolution plans. The creditors' committee will also reduce the company's

ISSN: 2582-6433

financial risk. However, the Committee of Creditors is also entrusted with commercial knowledge, allowing them to make the most important decisions affecting the company's future. Also, the judgments of the Supreme Court in Essar Steel India Limited Committee of Creditors vs. Satish Kumar Gupta and K. Sashidhar v. Indian Overtseas Bank has restrained the Committee of Creditors by observing the limitation of their power or in simpler words, the power of COC may extent to a particular limit. Therefore, the impact of creditor-in-control model management promises a stronger bankruptcyregime by delegating such rights to the company's creditors.

4. Primary Focus Of The Legislation Elaborated In Swiss Ribbons Pvt. Ltd. And Anr. V. Union Of India And Ors..

- The constitutionality of different provisions of the Code was the issue herein. The most important issue in this case was that members of the National Company Law Tribunal [NCLT] and certain members of the National Company Law Appellate Tribunal [NCLAT], aside from the President, had been appointed in violation of this Court's judgement in Madras Bar Association v. Union of India, [Madras Bar Association (III)], and that, as a result, all orders made by such members were invalid.
- It had criticised Section 7 of the Code's legislative system, claiming that there was no actual distinction between financial and operational creditors. Both types of creditors, he claims, would give money in the form of loans or money's worth in the form of products and services. It was asserted that there was hostile discrimination against operational credit, even if there was a valid separation between financial and operational creditors. Inter alia, vested right was taken away by application of Section 29A(Resolution applicant)
- The Court while disposing this appeal stated the following in relation to the above issues:
  "16. The learned Attorney General has assured us that this judgment will be followed and Circuit Benches will be established as soon as itis practicable. In this view of the matter, we record this submission and direct the Union of India to set up Circuit Benches of the NCLAT within a period of 6 months from today."

ISSN: 2582-6433

Regarding the distinction between financial and operational creditors, theCourt stated that there was an intelligible difference between the two typesof creditors as long as there was some rational relationship between the two types of creditors.

"20. The tests for violation of Article 14 of the Constitution of India, on is challenged as being violative of the principle of equality, have been settled by this Court time and again. Since equality is only among equals, no discrimination results if the Court can be shown that there is an intelligible differentia which separates two kinds of creditors so long as there is some rational relation between the creditors so differentiated, with the object sought to be achieved by the legislation. This aspect of Article 14 has been laid down in judgments too numerous to cite, from the very inception.

The application of Section 29A did not take away any vested rights. A resolution applicant who applied under Section 29A(c) did not have a

vested right to be considered for a resolution application. In other words,a resolution applicant had no vested right for consideration or approval ofits resolution plan.
Section 29 A of the Act is read as under:

"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
–

(a) …

(b) …

(c) [at the time of submission of the resolution plan][9] has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 (10 of 1949) or the guidelines of a financial sector regulator issued under anyother law for the time being in force, and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor:

Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to nonperforming

ISSN: 2582-6433

asset accounts before submission of resolution plan:

Provided further that nothing in this clause shall apply to a resolution applicant where such applicant is a financial entity and is not a relatedparty to the corporate debtor.

Explanation I.- For the purposes of this proviso, the expression "relatedparty" shall not include a financial entity, regulated by a financial sector regulator, if it is a financial creditor of the corporate debtor andis a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, prior to the insolvency commencement date.

Explanation II.— For the purposes of this clause, where a resolution applicant has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is apromoter, classified as non-performing asset and such account was acquired pursuant to a prior resolution plan approved under this Code,then, the provisions of this clause shall not apply to such resolution applicant for a period of three years from the date of approval of such resolution plan by the Adjudicating Authority under this Code;

(d) …"

To this the Supreme Court has stated the following in the judgment as:

"65…….However, in our judgment in ArcelorMittal (supra), we have already held that resolution applicants have no vested right to be considered as such in the resolution process. Shri Mukul Rohatgi, however, argued that this judgment is distinguishable as no question of constitutional validity arose in this case, and no issue as to the vested right of a promoter fell for consideration. We are of the view that the observations made in ArcelorMittal (supra) directly arose on the facts of the case in order to oust the Ruias as promoters from the pale of consideration of their resolution plan, in which context, this Court held that they had no vested right to be considered as resolution applicants. Accordingly, we follow the aforesaid judgment. Since a resolution applicant who applies Under Section 29A(c) has no vested right to apply for being considered as a resolution applicant, this pointis of no avail."

ISSN: 2582-6433

5. Operational Creditors powers elaborated in K. Kishan vs. Vijay Nirman Company Pvt. Ltd. (14.08.2018 - SC) : MANU/SC/0872/2018

The question brought herein was whether operational creditors could use the Insolvency Code either prematurely or for extraneous considerations. The Court observed that the Code's object, at least in terms of operational creditors, was to use the bankruptcy procedure against a corporate debtor only in unambiguous circumstances where there was no genuine dispute between the parties about the debt owed.

"13. Following this judgment, it becomes clear that operational creditors cannot use the Insolvency Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures. The alarming result of an operational debt contained in an arbitral award for a small amount of say, two lakhs of rupees, cannot possibly jeopardize an otherwise solvent company worth several crores of rupees. Such a company would be well within its rights to state that it is challenging the Arbitral Award passed against it, and the mere factum of challenge would be sufficient to state that it disputes the Award. Such a case would clearly come within para 38 of Mobilox Innovations (supra), being a case of a pre- existing ongoing dispute between the parties. The Code cannot be used in terrorem to extract this sum of money of Rs. two lakhs even though it may not be finally payable as adjudication proceedings in respect thereto are stillpending. We repeat that the object of the Code, at least insofar as operational creditors are concerned, is to put the insolvency process against a corporate debtor only in clear cases where a real dispute between the parties as to the debt owed does not exist."

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Volume 2 Issue 7 | June 2022
ISSN: 2582-6433

6. Suspended Board of Directors and their responsibilities elaborated in Vijay Kumar Jain vs. Standard Chartered Bank and Ors. (31.01.2019 - SC)

: MANU/SC/0111/

The question of whether the resolution professional should submit all papers to the suspended board of directors of the corporate debtor, including the insolvency resolution plans. However, the Court went on to say that a resolution plan that has been authorised or rejected by an Adjudicating Authority decision must be given to "participants," which would include former Board of Directors members. Inter alia held that members of the erstwhile Board of Directors, being vitally interested in resolution plans that may be discussed at meetings of the CoC, must be given a copy of such plans as part of "documents" that have to be furnished along with the notice of such meetings. This is stated in the following extract from the judgment of the Supreme Court in the matter :

"9. This statutory scheme, therefore, makes it clear that though the erstwhile Board of Directors are not members of the committee of creditors, yet, they have a right to participate in each and every meeting held by the committee of creditors, and also have a right to discuss along with members of the committee of creditors all resolution plans that are presented at such meetings Under Section 25(2)(i). It cannot be gainsaid that operational creditors, who may participate in such meetings but have no right to vote, are vitally interested in such resolution plans, and must be furnished copies of such plans beforehand if they are to participate effectively in the meeting of the committee of creditors. This is for the reason that Under Section 30(2)(b), repayment of their debts is an important part of the resolution plan qua them on which they must comment. So the first important thing to notice is that even though persons such as operational creditors have no right to vote but are only participants in meetings of the committee of creditors, yet, they would certainly have a right to be given a copy of the resolution plans before such meetings are held so that they may effectively comment on the same to safeguard their interest."

ISSN: 2582-6433

The suspended directors are handed over the responsibility to obligate with the strategy that contributes to reduce to reduce their personal indebtedness. Being well- versed with the company's activities, they may be able to assist the COC in deciding whether the resolution plan meets the company's cause of default (a
mandatory requirement for resolution plans). Also, the Supreme Court stated that the resolution professional can obtain a confidentiality agreement that can take the form of a non-disclosure agreement, that will contributing in protectingthe resolution professional and its confidentiality.

"15. As a result of the aforesaid discussion, the arguments of the Respondents that "committee" and "participant" are used differently, which would lead to the result that resolution plans need not be furnished to the erstwhile members of the Board of Directors, must be rejected. Equally, the Regulations, far from going beyond the Code, flesh out the true intention of the Code that is achieved by reading the plain language of the Sections that have already been adverted to. So far as confidential information is concerned, it is clear that the resolution professional can take an undertaking from members of the erstwhile Board of Directors, as has been taken in the facts of the present case, to maintain confidentiality. The source of this power is Regulation 7(2)(h) of the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016, read with paragraph 21 of the First Schedule thereto. This can be in the form of a non-disclosure agreement in which the resolution professional can be indemnified in case information is not kept strictly confidential."

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7. Ineligible promoters under Section 29A and their entitlement to file for application and compromise elaborated in Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr.

Using its precedents, derived from Supreme Court's Judgment in Chitra Sharma v. Union of India and Arcelormittal India Private Limited v. Satish Kumar Gupta& Ors the Supreme Court held that courts should apply a purposefulinterpretation of Section 29A of the IBC, which serves as a critical link in ensuring that the IBC's objectives are

ISSN: 2582-6433

not defeated by allowing the company's management (who have run it aground) to return to the corporate debtor as resolution applicants. It was noted that Section 35(1)(f) of the IBC is comparableto Section 29A of the IBC, but only applies when the corporate debtor is in the process of liquidation. That The IBC's Section 29A was enacted in the public interest and to allow for sound company governance. Section 29A eliminates a loophole in the IBC that formerly permitted former corporate debtors' management to have backdoor access to the bankruptcy resolution process.

The Judgment stated the following:

"69. The IBC has made a provision for ineligibility Under Section 29A which operates during the course of the CIRP. A similar provision is engrafted in Section 35(1)(f) which forms a part of the liquidation provisions contained in Chapter III as well. In the context of the statutory linkage provided by the provisions of Section 230 of the Act of 2013 with Chapter III of the IBC, where a scheme is proposed of a company which is in liquidation under the IBC, it would be far-fetched to hold that the ineligibilities which attach Under Section 35(1)(f) read with Section 29A would not apply when Section 230 is sought to be invoked. Such an interpretation would result in defeating the provisions of the IBC and must be eschewed."

7.2 Constitutional Validity of Regulation 2B- Liquidation Process Regulations

The Court observed that the scheme to compromise and arrangement is to revivethe company. Given this, there can be no doubt that the proviso to Regulation 2B was intended to clarify something. A person who was disqualified under Section 29A would not be allowed to offer a compromise or arrangement under Section 230 of the Act of 2013, even if the proviso was removed. As a result, the challenge to the legitimacy of Regulation 2B was without substance.

"84. The principal ground of challenge to Regulation 2B is that the Regulation the authority of IBBI by introducing a disqualification or ineligibility in regard to the presentation of an application for a scheme of compromise or arrangement Under Section 230 of the Act of 2013. It has been urged that IBBI, as an entity constituted by the IBC, had no statutory jurisdiction to amend the provisions of Section 230 of the Act of 2013 or to impose a restriction which operates under the purview of Section 230. The position in our view can be considered from two perspectives, independent of the provisions of

ISSN: 2582-6433

Regulation 2B. We have indicated in the discussion earlier that even in the absence of the Regulation 2B, a person ineligible Under Section 29A read with Section 35(1)(f) is not permitted to propose a scheme for revival Under Section 230, in the case of a company which is undergoing a liquidation under the IBC. We have come to the conclusion, as noted for the reasons indicated earlier, that in the case of a company which is undergoing liquidation pursuant to the provisions of Chapter III of the IBC, a scheme of compromise or arrangement proposed Under Section 230 is a facet of the liquidation process. The object of the scheme of compromise or arrangement is to revive the company. The principle was enunciated in the decision in Meghal Homes (supra) while construing the provisions of erstwhile Section 391. The same rationale which permeates the resolution process under Chapter II (by virtue of the provisions of Section 29A) permeates the liquidation process under Chapter III (by virtue of the provisions of Section 35(1)(f)). That being the position, there can be no manner of doubt that the proviso to Regulation 2B is clarificatory in nature. Even absent the proviso, a person who is ineligible Under Section 29A wouldnot be permitted to propose a compromise or arrangement Under Section 230 of the Act of 2013. We therefore do not find any merit in the challenge to the validity of Regulation 2B."