May 2023

Supreme Court holds that revised resolution plan cannot be approved by the Adjudicating Authority without being placed before the Committee of Creditors

The Supreme Court ("**SC**") in the case of ***M. K. Rajagopalan v. Dr. Periasamy Palani Gounder & Anr.***, has held that, while commercial wisdom of the Committee of Creditors ("**CoC**") must be respected, certain factors having a material bearing on the process of approval of the resolution plan should also be borne in mind. The SC dealt extensively with the objections raised by the Resolution Applicant ("**RA**") as well as the Resolution Professional ("**RP**") and held that: a) it could not have been overlooked that the RA was ineligible due to the restriction under Section 88, Indian Trusts Act, 1882 ("**Trusts Act**") as well as Companies Act, 2013 ("**Companies Act**"), and b) the revised resolution plan was directly sent for approval of the Adjudicating Authority instead of being placed before the CoC.

Facts of the Case:

- Appu Hotels Limited, the Corporate Debtor ("**CD**"), availed project loans to construct '**Le Meridian, Coimbatore'**. For various reasons, the business did not materialize, and the CD defaulted on the loan repayment. Such default led to one of the financial creditors, Tourism Finance Corporation of India Limited ("**TFCIL**") filing an application under Section 7 of the Insolvency & Bankruptcy Code, 2016 ("**IBC**") before the National Company Law Tribunal, Chennai ("**Adjudicating Authority**").
- On May 5, 2020, Corporate Insolvency Resolution Process ("**CIRP**") was initiated with respect to the CD, pursuant to admission of the application under Section 7 filed by TFCIL. CIRP was commenced and claims were invited. Thereafter, around August 2020, expression of interests ("**EOIs**") was invited from prospective resolution applicants.
- 13 (thirteen) EOIs were received. Out of the 13 (thirteen) EOIs, one was withdrawn and another, from Sri Balaji Vidyapeeth (notably, the RA was the managing trustee), was found to be ineligible. This was since Sri Balaji Vidyapeeth was a charitable trust, which was barred by law from running a profit-making entity (Section 88 of the Trusts Act).
- Finally, 3 (three) resolution plans were received. One of these resolution plans was submitted by the appellant RA on October 27, 2020 ("**Resolution Plan**"). Another of the three resolution plans submitted was found to be non-compliant with the requirements under the IBC.
- In the meanwhile, owing to a revision of claims as well as the composition of financial creditors, the remaining two resolution applicants were asked to submit their respective revised resolution plans. The Appellant / RA was the only one to submit the revised resolution plan. This was decided to be put up for voting before the CoC on January 22, 2021. On January 21, 2021, the promoter and former director of the CD submitted a one-time-settlement proposal with reference to Section 12-A of the IBC (pertaining to withdrawal of application admitted under Section 7, 9 or 10 of the IBC). However, the CoC decided to proceed with voting on the Resolution Plan by the Appellant /

RA. This was approved by 87.39% of the total voting share of the financial creditors present and voting. However, since there were some dissenting financial creditors, the Resolution Plan was sent back to the Appellant / RA to ensure that the amount to be paid to such dissenting financial creditors is not less than what they would have been paid in case of liquidation under Section 53 of the IBC.

- When the Appellant / RA submitted the revised Resolution Plan, instead of placing it before the CoC again for voting, the RP presented the same before the Adjudicating Authority for approval. Notably, while the matter was pending before the Adjudicating Authority, the CD submitted another settlement proposal to TFCIL and requested TFCIL to withdraw its Application under Section 12-A of the IBC.
- On July 15, 2021, after hearing the parties, the Adjudicating Authority rejected the objections raised against the resolution plan and approved the same. Aggrieved, the former promoter of the CD along with a related party to the CD and one NRI shareholder of the CD appealed before the National Company Law Appellate Tribunal ("**Appellate Tribunal**").
- On February 17, 2022, the Appellate Tribunal reversed the decision of the Adjudicating Authority, rejected the Resolution Plan, and remanded the matter back to the CoC.
- Aggrieved by this, the present appeals were filed before the SC by the RP and RA.

Key Issues Raised

1. Whether the valuation process of the assets of the CD was in violation of Regulations 27 and 35 of the CIRP Regulations and therefore, approval of the resolution plan is in contravention of Sections 30 (2) and 61 (3) of the IBC?
2. Whether there was non-compliance with Regulation 36-A (2) (iii) of the CIRP Regulations for want of publication of Form-G on the designated website not later than 75 days from the insolvency commencement date; and failure to advertise as mandated is a direct impact on the maximization of asset value, particularly when the entire CIRP was conducted during lockdown during the COVID-19 pandemic?
3. Whether the appellant/ RA is ineligible in terms of Section 29-A (e) of IBC for being disqualified to act as a director u/s 164(2)(b) of the Companies Act?
4. Whether the appellant / RA is ineligible to submit the resolution plan to act as an alter ego of the trust "**Sri Balaji Vidyapeeth**" that was already declared ineligible?
5. Whether the resolution plan leads to violation of Section 166(4) of the Companies Act and hence cannot be approved in terms of Section 30(2)(e) of the IBC?
6. Whether the Appellate Tribunal has erred in holding that the resolution plan in question, which was directly placed before the Adjudicating Authority for approval after re-submission, instead of being put up before the CoC for voting, was void and non-est in law?
7. Whether the Appellate Tribunal has erred in applying the principle of non-discrimination as regards related party of the CD and thereby holding against the resolution plan for lack of providing for such related party?
8. Whether the Appellate Tribunal has erred in holding that the settlement offer of the former promoter of the CD was not placed before the CoC and if this had a bearing on the approval of the resolution plan?

Decision

Re: Valuation process

The SC rejected the findings of the Appellate Tribunal as regards the aspect of valuation of the CD. The SC's findings were on the basis that the CoC was provided with the fair value and liquidation value of the CD. Any issues raised by the CoC were duly clarified by the RP, as is evident from various Minutes of Meetings. There is also no basis for the contention that the fair value had to be equivalent to the liquidation value. As such, the commercial wisdom of the CoC is not prejudiced. Therefore, the Appellate Tribunal had unnecessarily held that the process of valuation was in violation of statutory provisions.

Re: Publication of Form-G

The Appellate Tribunal had primarily come to its conclusion on this aspect on the basis that due to COVID-19 since people avoided reading newspapers. Therefore, Form-G ought to have been published on the on the designated website. The Appellate Tribunal went further to say that this was a mandatory requirement and non-compliance amounted to material irregularity. The SC held that a statute dealing with a matter of practice or procedure is to be read as being directory and not mandatory. Therefore, given that no prejudice has been caused to any party, it cannot be held that non-publication of Form-G on the designated website amounted to a material irregularity.

Re: Effect of Section 164(2)(b) of the Companies Act

The SC rejected the finding of the Appellate Tribunal that since a company of which the Appellant / RA is a director, had failed to refund the share application money, this will amount to a default and disqualify the Appellant / RA as a director, and consequently, make him ineligible to submit a resolution plan. The SC categorically observed that even if any such disqualification were to be suffered by the Appellant / RA, this would be a matter for consideration by the Registrar of Companies. Also, the DIN status of the Appellant / RA was reflected as "active compliant". On the face of this, the Appellant / RA cannot be treated as ineligible.

Re: Alter ego of Sri Balaji Vidyapeeth and Section 88 of the Trusts Act

Referring to Section 88 of the Trusts Act, the SC held that the Appellant / RA being the managing trustee of Sri Balaji Vidyapeeth, could not be permitted to act as its alter ego and implement the resolution plan to gain financial advantage. In coming to this conclusion, the SC examined the Resolution Plan submitted by the Appellant / RA wherein it was admitted that the Appellant / RA is the founder of the charitable trust and that under his leadership, it was rapidly growing. Therefore, the finding of the Appellate Tribunal in this regard, that Section 88 of the Trusts Act rendered the Appellant / RA ineligible was correct.

Re: Effect of Section 166(4) of the Companies Act

- The SC observed that the Appellant / RA was the managing director of MGM Healthcare Private Limited, a super specialty hospital. As per the Resolution Plan, the Appellant / RA has stated that he proposed to convert the Coimbatore property into a hospital.
- In this situation, the embargo under Section 166(4) of the Companies Act, which prohibits a director of a company from involving himself in a situation in which such director may have a direct or indirect interest which may conflict with the interest of another company, applies to the facts of the present case. Therefore, the Appellant / RA could not have been accepted as a resolution applicant.

Re: Revised resolution plan not placed before the CoC but directly before the Adjudicating Authority for approval

- The SC examined the law pertaining to the commercial wisdom and the primacy afforded to the CoC and referred to the decisions of the SC in *K. Sashidhar v. Indian Overseas Bank,* (2019) 12 SCC 150 and *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others*, (2020) 8 SCC 531 and observed that the term 'commercial wisdom of CoC' means a considered decision taken by CoC with reference to the commercial interests of the stakeholders and to ensure maximization of value of assets of the CD.

- The SC observed that what is necessary under the law concerning commercial wisdom of CoC is that the CoC ought to examine all the relevant information available before it and duly deliberate on the same. Every aspect relating to resolution plan, including its financial layout, must be placed before the CoC before it could be said to have arrived at a considered decision in its commercial wisdom. No such opportunity was afforded to the CoC in the present case.
- There is no and there cannot be any concept of *post facto* approval of any resolution plan by CoC which had not been placed before it prior to the filing before the Adjudicating Authority.

Re: Related party and not placing the settlement offers before the CoC

- The SC rejected the findings regarding not considering the related party which amounted to discriminating against such related party on the basis that this is not founded in law and a catena of judgments have upheld resolution plans not providing for any payment to related parties.
- As regards the settlement offers of the former promoter of the CD not being put up before the CoC, the SC rejected the Appellate Tribunal's findings in this regard and concurred with the finding of the Adjudicating Authority. The Adjudicating Authority, after analysing the conduct of the former promoter, noted two points –
  1) the settlement offer by the former promoter of the CD was silent as regards the source of funds for completing the settlement, and
  2) the timing of the submission of settlement plans, which were always done after the CIRP had progressed substantially and at the last minute, reflected an intention to adopt dilatory tactics. Therefore, there was no merit to this contention.

Conclusion

- The SC decision is to the effect that while respecting the commercial wisdom of the CoC, the resolution plan submitted by the resolution applicant could not have been approved by the Adjudicating Authority primarily for two reasons, namely –
  - That the RA was ineligible to submit Resolution Plan in view of Section 88 of the Trusts Act and Section 166(4) of the Companies Act; and
  - The revised Resolution Plan was not put up before the CoC prior to presenting it before the Adjudicating Authority for approval.
- The SC has observed that under the garb of commercial wisdom of CoC, glaring irregularities in the submission and approval of a resolution plan and not affording an opportunity to the CoC to deliberate on every aspect of the resolution plan including its financial layout cannot be ignored. Therefore, while considering and voting with respect to a resolution plan, the CoC must consider every aspect. If this process is not followed, it cannot be said that the CoC has duly approved the resolution plan and exercised its commercial wisdom.
- The SC stated that presenting the revised resolution plan directly to the NCLT without final approval from the CoC cannot be dismissed as a mere technicality. It is necessary for the CoC to consider the financial layout of the plan before reaching a final decision. Therefore, if a modified resolution plan, regardless of how minor the modification/revision may be, is not approved by the CoC, then presenting it to the Adjudicating Authority for approval is a serious irregularity that cannot be rectified.

Disputes Practice

With domain experts and strong team of dedicated litigators across the country, JSA has perhaps the widest and deepest commercial and regulatory disputes capacity in the field of complex multi-jurisdictional, multi-disciplinary dispute resolution. Availing of the wide network of JSA offices, affiliates and associates in major cities across the country and abroad, the team is uniquely placed to handle work seamlessly both nationally and worldwide.

The Firm has a wide domestic and international client base with a mix of companies, international and national development agencies, governments and individuals, and acts and appears in diverse forums including regulatory authorities, tribunals, the High Courts, and the Supreme Court of India. The Firm has immense experience in international as well as domestic arbitration. The Firm acts in numerous arbitration proceedings in diverse areas of infrastructure development, corporate disputes, and contracts in the area of construction and engineering, information technology, and domestic and cross-border investments.

The Firm has significant experience in national and international institutional arbitrations under numerous rules such as UNCITRAL, ICC, LCIA, SIAC and other specialist institutions. The Firm regularly advises and acts in international law disputes concerning, amongst others, Bilateral Investor Treaty (BIT) issues and proceedings.

The other areas and categories of dispute resolution expertise include; banking litigation, white collar criminal investigations, constitutional and administrative, construction and engineering, corporate commercial, healthcare, international trade defence, etc.

JSA represented one of the financial creditors in this matter. JSA team comprised **Varghese Thomas** (Partners), **Dheeraj Nair** (Partners) and **Aditi Deshpande** (Partners); and **Vishrutyi Sahni** (Senior Associate)

Varghese Thomas
Partner

Dheeraj Nair
Partner

Aditi Deshpande
Partner

Vishrutyi Sahni
Senior Associate

This Prism has been prepared by:

Sidharth Sethi
Partner

Avinash Das
Senior Associate

17 Practices and
24 Ranked Lawyers

16 Practices and
11 Ranked Lawyers

7 Practices and
2 Ranked Lawyers

11 Practices and
39 Ranked Partners
IFLR1000 APAC Rankings 2022

Banking & Finance Team of the Year

Fintech Team of the Year

Restructuring & Insolvency Team of the Year

Among Top 7 Best Overall Law Firms in India and
9 Ranked Practices

---

11 winning Deals in IBLJ Deals of the Year

---

10 A List Lawyers in IBLJ Top 100 Lawyer List

Banking & Financial Services Law Firm of the Year 2022

Dispute Resolution Law Firm of the Year 2022

Equity Market Deal of the Year (Premium) 2022

Energy Law Firm of the Year 2021

Ranked #1
The Vahura Best Law Firms to Work Report, 2022

Top 10 Best Law Firms for Women in 2022

For more details, please contact km@jsalaw.com

jsa
advocates & solicitors

Ahmedabad | Bengaluru | Chennai | Gurugram | Hyderabad | Mumbai | New Delhi