

Due diligence of resolution applicants by resolution professionals: Mere reliance on an affidavit is not enough to check ineligibility under Section 29A of the IBC

In an application filed by Vishram Narayan Panchpor, resolution professional of Blue Frog Media Private Limited (“**Corporate Debtor**”) in the matter of *M/s Blue Frog Media Private Limited*¹ for approval of a resolution plan, the Mumbai bench of the National Company Law Tribunal (“**NCLT Mumbai**”) ruled that the object of Section 29A of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) requires a resolution professional to conduct adequate due diligence on a prospective resolution applicant and its related parties. The NCLT Mumbai implied that the resolution professional cannot merely rely on an affidavit provided by such an applicant to ensure that the resolution applicant does not fall under the criteria set out in Section 29A of the IBC.

Brief Facts

1. The Corporate Debtor filed an application under Section 10 of the IBC for initiating its own corporate insolvency resolution process (“**CIRP**”). The same was admitted through an order of NCLT Mumbai on May 19, 2021.
2. During the course of CIRP, in response to an invitation for expression of interest (“**EOI**”) published by the resolution professional of the Corporate Debtor (“**Applicant**”), 3 (three) EOIs were received. Out of the 3 (three) parties who submitted an EOI, only 2 (two) parties satisfied the eligibility criteria framed and approved by the committee of creditors (“**CoC**”). However, only one party eventually submitted a resolution plan to the Applicant, Mr. Mahesh Mathai (“**SRA**”), who was also a financial creditor of the Corporate Debtor. The resolution plan was submitted by the SRA in his individual capacity. The CoC suggested a few modifications to the draft resolution plan, which were incorporated by the SRA, and the resolution plan was finally approved by the CoC with a majority vote of 91.86%.
3. The present application (“**Application**”) under consideration was preferred by the Applicant under the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (“**CIRP Regulations**”), to seek approval of NCLT Mumbai on the CoC approved resolution plan.
4. Along with the Application, the Applicant annexed Form H of Schedule I of the CIRP Regulations to certify that the resolution plan approved by the CoC complied with all provisions of the IBC and the relevant regulations framed thereunder, including the CIRP Regulations. This implied that an affidavit affirming eligibility under Section 29A of the IBC was submitted by the SRA and the contents of the affidavit were found to be in order by the Applicant.
5. A perusal of the CoC approved resolution plan by NCLT Mumbai revealed that in addition to being a financial creditor of the Corporate Debtor, the SRA was also the founder of the Corporate Debtor. It was clarified by an affidavit dated July 26, 2023 submitted by the SRA that he held 5,13,458 (five lakhs thirteen thousand four hundred

¹ IA No.2828 of 2021 In CP (IB) No. 4360 /MB/C-I/2018 – Order dated August 18, 2023

and fifty eight) equity shares in the Corporate Debtor as at March 31, 2021. For a period ranging from July 20, 2006 till March 1, 2018, the SRA also served as a director of the Corporate Debtor. The SRA resigned as a director of the Corporate Debtor on March 1, 2018. In the extraordinary general meeting of the Corporate Debtor held on August 7, 2018, a special resolution was passed for filing an application under Section 10 of the IBC. The application under Section 10 of the IBC was ultimately filed by the Corporate Debtor on October 30, 2018.

6. NCLT Mumbai also noted that the SRA further acquired 76,701 (seventy six thousand seven hundred and one) shares by transfer on July 10, 2019, which took place after filing of the aforesaid application under Section 10 of the IBC for initiating CIRP.

Issues

Whether the SRA met the criteria stipulated under Section 29A of the IBC to be a resolution applicant?

Analysis and Findings of NCLT Mumbai

1. NCLT Mumbai noted that Section 29A(c) of the IBC was applicable in the instant case. Section 29A(c) disentitles a person from filing a resolution plan, if at the time of submission of the resolution plan, such person, or any other person acting jointly or in concert with such person, 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, is classified as non-performing asset as per guidelines issued by the Reserve Bank of India, and a period of 1 (one) year has elapsed from the date of such classification till the date of commencement of the CIRP.
2. NCLT Mumbai further noted the objects and purposes of Section 29A of the IBC, which essentially seek to prevent promoters from gaining a back-door entry into the management of corporate debtors. This is enabled by declaring such 'unscrupulous persons' or the 'related parties' as ineligible to submit a resolution plan under the IBC, whose misconduct resulted in the corporate debtor's financial distress. If such resolution plans are permitted, it would be an abuse of the provisions of the IBC and would undermine its stated objectives. It was observed that those who have contributed to the downfall of a corporate debtor cannot be permitted to have a continuing role in its future.
3. NCLT Mumbai also observed that a resolution professional is responsible for carrying out adequate due diligence for checking ineligibility of a prospective resolution applicant under Section 29A of the IBC. Submission of an affidavit by such a resolution applicant stating that he or she is not ineligible under Section 29A of the IBC is not sufficient. A resolution professional should carry out effective due diligence within the prescribed timelines, and seek clarifications, or additional information, or document, if required, for the purposes of the due diligence.
4. In this case, the SRA was a former promoter/director of the Corporate Debtor. An increase in his shareholding whilst the Corporate Debtor was under financial distress revealed his continuous involvement in the Corporate Debtor and gave rise to an assumption that the corporate debtor's downfall is due to the actions of its management, which included the SRA. The NCLT observed that resignation of the SRA as a director of the Corporate Debtor and filing of application under Section 10 of the IBC within a few months from the resignation, was nothing but a misuse of the provisions of the IBC.

In view of the aforesaid findings, NCLT Mumbai rejected the Application by noting that the resolution plan approved by the CoC was in violation of the rationale behind Section 29A of the IBC, which is to protect the interests of the creditors from persons who have contributed to the mismanagement and defaults committed by the Corporate Debtor.

Conclusion

This order of NCLT Mumbai serves as a reminder for resolution professionals to carefully examine the material placed on record while undertaking the due diligence of a prospective resolution applicant and not simpliciter rely on the contents of the documents furnished by a resolution applicant. The resolution professional may request clarifications,

additional documents or information from a prospective resolution applicant to achieve the purposes of the IBC and to protect the interests of the creditors.

Whilst Form H of Schedule I of the CIRP Regulations contains a certification by a resolution professional to the effect that an affidavit from a resolution applicant with respect to its eligibility under Section 29A of the IBC has been obtained and that the contents of such affidavit are in order, NCLT Mumbai implicitly referred to Regulation 36A(8) of the CIRP Regulations to conclude that mere submission of such an affidavit was not sufficient. A resolution professional needs to conduct an effective due diligence within the prescribed timelines to ascertain that the prohibitive criteria under Section 29A of the IBC are not met by a resolution applicant.

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