Why Section 29A needs calibration

The IBC must not conflate business failure with malfeasance, or an unfortunate entrepreneur with a fraudulent one

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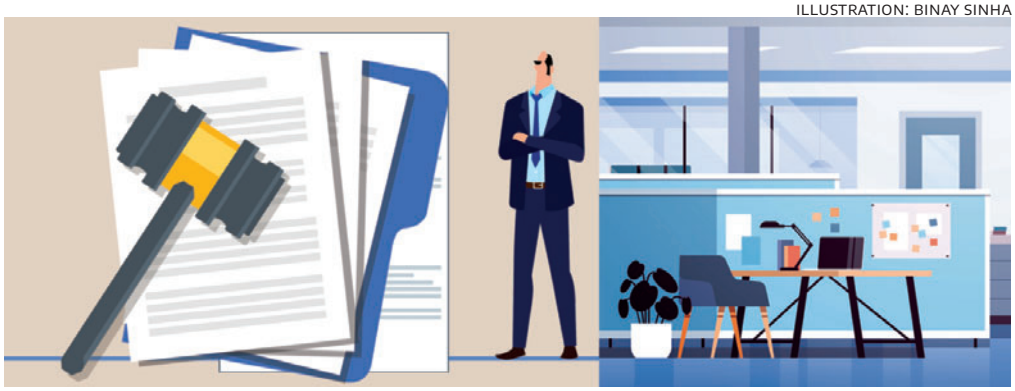

The first resolution plan under the Insolvency and Bankruptcy Code (IBC), 2016, approved in August 2017, triggered widespread disquiet. A related party regained control of the company while creditors took a 94 per cent haircut. This outcome appeared commercially imprudent and morally indefensible, exposing the vulnerability of the nascent insolvency regime to abuse. The IBC could not be a route for errant promoters who had run a company into the ground to shed debt and reclaim assets. The government responded swiftly, inserting Section 29A to restore confidence in the regime.

Nearly a decade on, the twin balance-sheet syndrome that motivated early interventions has largely receded. In the changed landscape, Section 29A increasingly risks impeding the IBC's objective of value-maximising resolution by excluding precisely those actors who may be best placed to revive distressed assets. The question is whether Section 29A in its present form still continues to serve its purpose without imposing disproportionate collateral costs.

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Clause (c), for instance, disqualifies a promoter of a company that has a non-performing asset (NPA) account for at least one year before the commencement of the corporate insolvency resolution process (CIRP) of a company from submitting a resolution plan to take it over. This provision produces anomalous outcomes. A promoter of several companies, each with substantial NPAs for decades, retains control of those companies so long as none of those companies is admitted into CIRP. By contrast, a promoter of a single company with a relatively small NPA for a year loses the company if that company enters insolvency. Disqualification thus turns not on the existence, magnitude, or persistence of NPA, but on the happenstance of admission into CIRP, an outcome often shaped by creditor strategy rather than promoter conduct.

The distortion runs deeper. A person with modest defaults to banks is disqualified, while someone else with massive defaults to non-bank creditors over decades remains eligible. By treating all *de jure* NPAs alike and ignoring *de facto* NPAs altogether, the provision privileges form over substance and classification over conduct. This asymmetry militates against equality, with no rational nexus to culpability.

Fundamentally, clause (c) disregards business reality. NPA classification may reflect systemic or sector-wide shocks, rather than promoter delinquency. Entire industries, notably thermal power and steel, experienced acute stress in the mid-2010s, triggered respectively by coal block cancellations and global steel price collapse, developments largely outside the promoter's control.

The provision sits uneasily with the dynamics of a market economy, where business failure is not aberrational but an inevitable by-product of competition and innovation. If bankruptcy law fails to distinguish honest failure from fraud, affording a second chance to the former while sanctioning the latter, it risks chilling entrepreneurship and, in turn, undermining the economy's growth trajectory.

Business cycles rarely conform to a one-year timeline. An account rendered NPA by a cyclical downturn may not recover within 12 months, even when the promoter is diligent and beyond reproach. *Force majeure* events such as the Covid-19 pandemic underscore this point. Acknowledging its extraordinary impact, the law itself excluded Covid-era defaults from triggering insolvency proceedings.

By barring promoters based solely on the duration of NPA, the law excludes the stakeholder with the deepest institutional knowledge of the asset. Strategic buyers may be unwilling to assume the complexity of a turnaround without the promoter's involvement, while financial investors may lack operational capability. The result is often a failed CIRP and eventual liquidation, destroying value and harming creditors.

The breadth of disqualification compounds the problem. It extends to persons acting in concert and to connected persons, casting an exceptionally wide net. While the intent was to prevent promoters from using proxies or fronts, the provision has the unintended effect of deterring genuine white knights who might otherwise partner with promoters to rescue distressed assets. A white knight who formed a consortium with a promoter who was eligible yesterday risks becoming ineligible across the market if that promoter attracts any ineligibility under Section 29A today.

It is sometimes argued that little turns on keeping just one person out. This understates the effect of Section 29A, which operates globally. Once disqualified, a person and all its connected persons are excluded from every insolvency proceeding, irrespective of the asset, the sector, or the circumstances. This materially shrinks the pipeline of resolution applicants, adversely affecting insolvency outcomes system-wide.

Section 240A exempts micro, small, and medium enterprises (MSMEs) from the rigours of clause (c). By permitting MSME promoters to re-enter despite NPA status, the legislature acknowledges that NPA classification is not, in itself, a marker of moral turpitude or managerial incompetence. The disqualification is situational, not character-based. Morality cannot reasonably depend on the size of the balance sheet. A promoter of a large steel plant, buffeted by global headwinds and guilty of no fraud, is arbitrarily barred, while an MSME promoter in comparable circumstances is welcome. This is jurisprudentially untenable. If MSME promoters merit a conduct-based assessment, large corporate promoters are equally entitled to one, rather than a blanket prohibition.

This analysis of clause (c) illustrates a broader problem. Section 29A is simultaneously over-inclusive and under-inclusive. It excludes promoters whose failure is honest and contextual, while allowing continued eligibility elsewhere until culpability is authoritatively established. Clauses (b) and (g), which address wilful default and avoidance transactions, quintessentially malafide conduct, disqualify only upon a final determination. Until then, even culpable actors may participate in the process. The resulting regime penalises the unfortunate while, at times, accommodating the suspect.

This is not an argument for dismantling Section 29A or returning to an era of promoter impunity. The moral hazard is real, and the law must guard against it. But the guardrails must be calibrated. Promoters who have stripped value or acted fraudulently should be barred at the threshold, based on credible forensic evidence. Promoters who have merely fallen victim to business cycles but continue to enjoy creditor confidence should not be treated as pariahs.

Section 29A was a necessary intervention at a particular moment in the evolution of India's insolvency framework. Today, the challenge is nuanced: Curbing misconduct without extinguishing value. The IBC will realise its full promise only when it sharply distinguishes fraud from failure, discipline from over-deterrence, and moral culpability from commercial misfortune. Calibration, not blunt exclusion, is the imperative.

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