Resolution Professional vis-a-vis Board of Directors: Governance of Insolvent Companies

- ***Sikha Bansal***

Editor's Note: *As discussed in the earlier article, RP acts as a driver of the corporate insolvency resolution process, balancing the interests of concerned stakeholders, simultaneously acting as an officer of the court. RP's functions are multi-faceted – besides taking care of the resolution process, the RP has to ensure that the company is being preserved as a going concern. As such, the RP steps into the shoes of the board of directors of the company.*

IBC contemplates that as soon as interim resolution professional assumes office, the management of the affairs of the corporate debtor shall vest with the interim resolution professional (and consequentially, the resolution professional), and the powers of the board of directors of the insolvent company shall stand suspended and be exercised by the interim resolution professional (and then, by the resolution professional).

There are views which hold that the board of directors lose their powers and as well as are relieved of their duties to perform functions which they are otherwise required to perform. This, however, does not seem to be going the right way – as the provisions are clear – initiation of corporate insolvency resolution process blocks the board of directors to do anything on their own will or even at the will of equity holders. The idea is to take away the "power" – that too, temporarily. The board, precisely, remains in animated suspension. This article visits various provisions as well as rulings to analyse the position of the board of directors in corporate insolvency resolution process s.

SEBI has issued a "Discussion Paper on Compliance with SEBI Regulations by Listed Entities undergoing Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016" on 28th March, 2018. The Discussion Paper proposes certain modifications in the applicable regulatory framework to facilitate insolvency resolution of listed corporate debtors while at the same time ensurin g that the interests of investors in securities of such corporate debtors are protected.

IBBI in its Circular No. No. IP/002/2018 dated 3rd January, 2018 has emphasised that a corporate person undergoing insolvency resolution process, fast track insolvency resolution process, liquidation

Figure 11: The Resolution Professional takes over the powers of the BoD

process or voluntary liquidation process under the Code needs to comply with provisions of the applicable laws (Acts, Rules and Regulations, Circulars, Guidelines, Orders, Directions, etc.) during such process. For example, a corporate person undergoing insolvency resolution process, if listed on a stock exchange, needs to comply with every provision of the LODR Regulations, unless the provision is specifically exempted by the competent authority or becomes inapplicable by operation of law for the corporate person. The Circular directed that while acting as an interim resolution professional, resolution professional or a liquidator for a corporate person under the Code, an insolvency professional shall exercise reasonable care and diligence and take all necessary steps to ensure that the corporate person undergoing any process under the Code complies with the applicable laws. Further, it was clarified that if a corporate person during any of the aforesaid processes under the Code suffers any loss, including penalty, if any, on account of non-compliance of any provision of the applicable laws, such loss shall not form part of insolvency resolution process cost or liquidation process cost under the Code. It is also clarified that the insolvency professional will be responsible for the non-compliance of the provisions of the applicable laws if it is on account of his conduct.

Thus, the aforesaid Circular, in effect, puts the resolution professional entirely into the shoes of the board of directors of the corporate debtor. The Discussion Paper too, makes references to the Circular. Therefore, the belief which seems to be building around is that the resolution professional completely replaces the board of directors and the executive machinery of the corporate debtor has to be operated by the resolution professional alone. This, however, seems to be a misplaced view, in light of the discussion made below.

Introduction

A corporate set-up is governed by the board of directors vested with general powers to manage the operations of the corporate entity; however, their powers are subject to the limitations set by the equity owners, the constitutional documents of the entity, and the laws governing the entity. As long as the company sails unruffled, the governance of the entity rests in the hands of the board of directors. However, as things go topsy-turvy, as the company starts defaulting on dues and fails to meet continuing obligations, the control goes for a change as per the scheme of the Code. When a company is sound, corporate governance ensures maximisation of benefits to each stakeholder. But when a company approaches default, the persons at the helm of affairs of the company, in anticipation of such default, may engage in customised and illicit transactions thereby depleting the wealth of the company and disregarding the legitimate rights of credit-providers. Therefore, in order to intercept such a behaviour, the Code envisages the design of 'creditor-in-possession". BLRC thus observes:

> *"The limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say."*

The Code provides for suspension of the powers of the board of directors of the corporate debtor and appointment of a resolution professional to manage the affairs of the corporate debtor. Such resolution professional is selected by a committee of creditors.

The Conundrum

As discussed in the *UNCITRAL Legislative Guide on Insolvency Law*, the insolvency laws tend to follow one of these approaches as regards continuing role of a debtor in reorganisation proceedings – (i) total displacement of the debtor, (ii) supervision of the debtor by the insolvency representative, and (iii) full control by the debtor.

In case of total displacement of the debtor, the procedure is the same as in liquidation, *removing all control of the business* from the debtor and appointing an insolvency representative to undertake the debtor's functions with respect to management of the business. While under the debtor-in-possession approach, the debtor retains full control over the operation of the business, with the consequence that the court does not appoint an independent representative once the proceedings commence. However, to mitigate the difficulties associated with this approach, certain protections may be adopted. Between these two extremes, intermediate approaches establish different levels of control between the debtor and the insolvency representative. *These generally involve some level of supervision of the debtor by the insolvency representative, such as where the latter broadly supervises the activities of the debtor and approves significant transactions, while the debtor continues to operate the business and take decisions on a day-to-day basis.*

In the context of our discussion, the moot question is – to what extent will the resolution professional replace the board of directors? The language of the Code coupled with remarks made by the courts is apparently puzzling the authorities, corporate boards, and the professionals too. Seemingly, there is a consensus building on the point that once an insolvency professional takes over the corporate debtor for taking it through the resolution process, the directors and other officers become entirely non-functional and it is the resolution professional who has to do anything and everything which a director has to do in respect of the company.

The above, however, does not seem to reflect the true intent of the Code. The resolution professional leads the resolution process so as to ensure that there is no malfeasance on the part of the board of directors, that those in control of the entity do not deplete the entity's wealth so much so that the creditors have to go empty-handed. However, appointment of a resolution professional is not intended to be an intrusive move – a professional coming in for some months is neither equipped nor should be expected to run a business established and being run for decades by those who are better placed to do so.

Before we proceed further, it would be relevant to note the relevant provisions of the Code and the observations made by the Supreme Court which has become more of a conundrum for the experts.

Stipulations in the Code

Section 17 of the Code*, inter-alia*, states,

> "17. (1) From the date of appointment of the interim resolution professional,—
>
> . . .

> (b) the powers of the board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional;
>
> (c) the officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional;
>
> . . ."

Sub-section (2) goes on to state that the interim resolution professional, vested with the management of the corporate debtor, shall act and execute in the name and on behalf of the corporate debtor all deeds, receipts, and other documents and shall have the authority to access the electronic records, books of accounts, records and other relevant records of the corporate debtor.

Section 19 of the Code runs as under:

> "(1) The personnel of the corporate debtor, its promoters or any other person associated with the management of the corporate debtor shall extend all assistance and cooperation to the interim resolution professional as may be required by him in managing the affairs of the corporate debtor."

Note that the word "personnel" includes the directors, managers, key managerial personnel, designated partners and employees, if any, of the corporate debtor (as defined under section 5 (23)).

Section 24 (3) perpetuates confusion when it says the resolution professional shall give notice of each meeting of the committee of creditors to the members of the "*suspended* board of directors or partners of the corporate debtor".

Section 25 (1) of the Code enunciates that it shall be the duty of the resolution professional "to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor". Sub-section (2) then lists down the actions to be undertaken for fulfilment of the duty stipulated under sub-section (1).

In *Para 11* of the judgment delivered in *Innoventive Industries Ltd v. ICICI Bank and Another* [Civil Appeal Nos. 8337-8338 OF 2017, the Supreme Court says, "According to us, once an insolvency professional is appointed to manage the company, the *erstwhile directors* who are no longer in management, obviously cannot maintain an appeal on behalf of the company . . . Entrenched managements are *no longer allowed to continue in management* if they cannot pay their debts."

The *obiter dicta* suddenly became a precedent in concluding that the Code is a confiscatory legislation by which the directors become "erstwhile directors" and the management is "no longer allowed to continue in management" once an insolvency professional is appointed.

We humbly diverge – reasons being deliberated as follows.

Suspension of powers of board vs. Suspension of board

Resolution Professional vis-a-vis
Board of Directors

Section 17 (1) talks about suspension of "powers" of the board of directors and partners of the corporate debtor, and exercise of those powers by the interim resolution professional/resolution professional. Therefore, the expression "suspended board of directors" as used in section 24 is misguided. In section 17, the word "suspended" qualifies "powers of the board", and not "board of directors" itself.

Cessation of powers must be distinguished from cessation of directorship. In *Rangai Goundan (M.K.), Re, (1942) 12 Com Cases 198, 201 : AIR 1942 Mad 702*, the Madras High Court held interpreting section 208A of the Companies Act, 1913 that the wording of the section suggests that the directors will lose their powers, but they will not cease to be directors. See also, *Steel Konnect (India) Pvt. Ltd. v. M/s. Hero Fincorp Ltd. [Company Appeal (AT) (Insolvency) No. 51 of 2017*] where the NCLAT clearly noticed that directors of the company do not cease to be directors, as they are not suspended but their function as "board of directors" is suspended [para 18].

See also*, M/s. Subasri Realty Private Limited v. Mr. N. Subramanian & Anr. [Company Appeal (AT) (Insolvency) No. 290 of 2017*], in which the NCLAT, Delhi in clear words, stated:

> ". . . we may clarify that after appointment of the Resolution Professional and declaration of moratorium, the Board of Director stands suspended, but that **does not amount to suspension of Managing Director or any of the Director or officer or employee of the Corporate Debtor.** To ensure that the Corporate Debtor remains on going concern, all the Director/ employees **are required to function and to assist** the Resolution Professional who manages the affairs of the Corporate Debtor during the period of moratorium. If one or other officer or employee had the power to sign a cheque on behalf of the Corporate Debtor prior to the order of moratorium, such power does not stand suspended on suspension of the Board of Directors nor can be taken away by the Resolution Professional. If, the person empowered to sign cheque refuse to function on the direction of the Resolution Professional or misuse the power, in such case it is always open to the Resolution Professional to take away such power after notice to the person concerned."

Board of directors vs. Individual directors

The board of directors works as a collective body, and the directors, in their individual capacity, are not empowered to exercise the powers which the board is entitled to exercise. There is nothing which stipulates that the directors in the board of directors of the corporate debtor shall be suspended or shall vacate their offices. It precludes them from *working as a "board"*. The board of directors is still there, but is powerless in doing acts which they have been empowered to do under the law. However, the directors who constitute the board are there and are NOT relieved from their duties and functions. This is evident from section 19 which mandates the personnel of the corporate debtor to assist the resolution professional in managing the affairs of the corporate debtor.

"Officers" to report to the Resolution Professional

The point presented above gets substantiated by what has been stated in clause (c) of section 17 (1) of the Code that the officers and managers of the corporate debtor shall report to the interim resolution professional. The expression "officer" has not been defined under the Code, hence reference shall be drawn to the Companies Act, 2013.

Section 2 (59) of the Companies Act, 2013 defines "officer" so as to include "any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the board of directors or any one or more of the directors is or are accustomed to act". Therefore, the officers of the corporate debtor, whether or not in the board of directors, are not suspended; they merely start functioning under the overall control and supervision of the resolution professional.

As defined under section 2 (53) of the Companies Act, 2013, "manager" means "an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not". A manager is thus a part of the executive management – day-to-day affairs of the company are managed by the executive management under the superintendence, control and direction of the board of directors. Once the resolution proceedings commence, the manager (whether he is a director or not), becomes accountable to the resolution professional. He will continue performing his activities subject to the directions and instructions of the resolution professional. *The resolution professional taking over the management of the corporate debtor does not imply that he has to perform day-to-day acts in relation to the company.*

The Role of Chief Executive Officer or Managing Director

Section 2 (54) of the Companies Act, 2013 defines "managing director", as a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The managing director of the company wears two hats – that of a director, and that of a chief managerial person or employee of the company. *Apropos* to his role of being the chief managerial person of the company, he knows the company's affairs, its business, its markets, and its resources in and out. As such, he is "entrusted" with substantial powers of managing the company. The acumen of the think-tank of a business and the expertise of a specialized professional like insolvency professional operate in two different domains and cannot be used as substitutes for each other.

The managing director cannot be uprooted from his position until he acts *malafide*. His powers remain dormant till the continuation of the resolution period. Any act proposed to be done by the managing director shall be subject to concurrence of the resolution professional.

"Preserve and Protect" Continued Business Operations of the Corporate Debtor

It is the duty of the resolution professional, as stipulated under section 25 (1), to *preserve and protect* the continued business operations of the corporate debtor. The provision does not ask the resolution professional to look into the business operations of the corporate debtor. For the purpose of protecting and preserving the continued business operations of the corporate debtor, the resolution professional shall undertake the tasks listed under sub-section (2) of section 25. A bare perusal of the list shows that most of the tasks are related to the conduct of the resolution process and those related to the corporate debtor directly are either custodial or supervisory or

representative in nature. The resolution professional has to step in where there are difficulties in continued business operations of the corporate debtor.

Conflict of Interests of Resolution Professional

In *Steel Konnect (India) Pvt. Ltd. v. M/s. Hero Fincorp Ltd. [Company Appeal (AT) (Insolvency) No. 51 of 2017]* it was held that the board of directors or partners of the corporate debtor, as the case may be is suspended and their power can be exercised by the interim resolution professional, but such exercise of power is limited to the extent to sub-section (2) of section 17 of the Code and not for any other purpose. It is desirable to notice that though pursuant to section 17, the board of directors of a corporate debtor stands suspended (for a limited period of corporate insolvency resolution process – maximum 180 days or extended period of 90 days i.e. 270 days), *but they continue to remain as directors and members of the board of directors for all purpose* in the records of Registrar of Companies under the Companies Act, 2013. Therefore, the corporate debtor has the right to prefer appeal under sub-section (1) of section 61 through its board of directors or authorise person or its officers.

> ***Steel Konnect vs. Hero Fincorp:***
>
> ***"the board of directors or partners of the corporate debtor, as the case may be is suspended and their power can be exercised by the interim resolution professional, but such exercise of power is limited to the extent to sub-section (2) of section 17 of the Code and not for any other purpose"***

Hence, where there are matters evidencing conflict of interests of the resolution professional with the interest of the corporate debtor, the directors shall be free to represent the corporate debtor before the courts. If the corporate debtor is left in the hands of the resolution professional to raise its grievance by filing an appeal under section 61 of the Code, it will be futile, as no resolution professional will challenge the initiation of corporate insolvency resolution process which ultimately will challenge his appointment.

Though the order of the NCLAT in *Steel Konnect (supra)* is juxtaposed to the observation made by the Hon'ble Supreme Court in *Innoventive Industries (supra),* yet the assertions made by the former also deserve commendation.

Resolution vs. Liquidation

It might be relevant to note sub-section (7) of section 33 of the Code. It stipulates that "the order for liquidation under this section shall be deemed to be a *notice of discharge* to the officers, employees and workmen of the corporate debtor, *except* when the business of the corporate debtor is continued during the liquidation process by the liquidator".

Two important points may be noted here –

When an entity goes into liquidation, the order of liquidation is deemed to be a notice of discharge to the officers, employees and workmen. As such, these persons vacate their respective offices. The law explicitly provides for vacation of their offices. Such a provision cannot be said to the same as that contained under section 17. "Suspension" should be differentiated from "discharge".

Where the business of the corporate debtor is continued during the liquidation process by the liquidator, the order *shall not be taken*to be a notice of discharge to officers and employees of the corporate debtor. This exception leads to the corollary that in case the entity is allowed to continue its operations, the officers shall continue serving their respective functions, which is the case during resolution.

Besides, the revival provisions contained in the Companies Act, 1956/2013 could never be implemented, certain provisions relating to winding up or liquidation might be relevant. Section 491 of the Companies Act, 1956 stated,

> "On the appointment of a liquidator, all the powers of the Board of directors and of the managing or whole-time directors and manager, if there be any of these, shall cease, except for the purpose of giving notice of such appointment to the Registrar in pursuance of section 493 or insofar as the company in general meeting or the liquidator may sanction the continuance thereof."

Section 313 of the Companies Act, 2013 (the provision has now been omitted by virtue of amendments made by the Code) corresponds to section 491 of the Companies Act, 1956. It is notable that the above provision explicitly provided for cessation of the powers of the managing and whole time directors. However, the Code preserves (i.e. suspends and does not cease), and thoughtfully so, the powers of the employees of the company, which must be deemed to preserve the powers of the key managerial personnel of the company.

Closure of resolution process

What happens to the powers of the board of directors once the insolvency resolution process period is over? Where the resolution proceedings conclude a resolution plan for implementation, the board comes back to power subject to the provisions of the resolution plan. Where the resolution proceedings fail and the entity is taken into liquidation stage, the officers and employees are automatically discharged.

The Concern

The views that are currently prevailing that once the insolvency resolution period commences, there would be no board meetings, there would be no audit committee meetings, that the resolution professional will sign each and every document relating to the corporate debtor, that the resolution professional shall be do all the filings are completely misguided.

A resolution professional takes over the management of the corporate debtor on *"as is"* basis – just that the management comes under the powers of the resolution professional conferred on him under the law. The officers continue functioning as they used to. The meetings of the board and that of the committees of the board will continue to be conducted in accordance with the applicable laws. The concerned officials will continue filing and maintaining records and documents as required under various laws. However, the overall governance of the corporate debtor will go in the hands of the resolution professional so as to ensure that the corporate debtor goes through the resolution process *sans* hindrances. The functional machinery of the corporate debtor remains intact under the controlled supervision of the resolution professional.

Resolution Professional vis-a-vis
Board of Directors

The BLRC defined the boundaries of the functions performed by an insolvency professional –

> "In administering the resolution outcomes, the role of the IP encompasses a wide range of functions, which include adhering to procedure of the law, as well as accounting and finance related functions. . . . In performing these tasks, *an IP acts as an agent of the adjudicator*. In a way the adjudicator depends on the specialized skills and expertise of the IPs to carry out these tasks in an efficient and professional manner.
>
> ***"THE RESOLUTION PROFESSIONAL IS RATHER AN AGENT OF THE ADJUDICATING AUTHORITY AND NOT OF THE COMPANY OR ANY OF ITS STAKEHOLDERS. A RESOLUTION PROFESSIONAL IS A SPECIALISED PROFESSIONAL AND NOT AN EMPLOYEE OF THE CORPORATE DEBTOR OR A BUSINESSMAN"***
>
> The role of the IPs is thus vital to the efficient operation of the insolvency and bankruptcy resolution process. A well-functioning system of resolution driven by IPs enables the adjudicator to delegate more and more powers and duties to the professionals. This creates the positive externality of better utilisation of judicial time."

Thus, the resolution professional is rather an agent of the adjudicating authority and not of the company or any of its stakeholders. A resolution professional is a specialised professional and not an employee of the corporate debtor or a businessman – his task is to facilitate and catalyse the resolution of the corporate debtor and not get entangled in daily affairs of the company unless that comes as an obstacle to continued business operations of the corporate debtor. *The business of a resolution professional is not to do business but to facilitate survival of business.* The resolution professional, in the short span of time allowed to him and given the object with which he has been appointed, cannot be put into multiple shoes. Any other interpretation of the provisions may lead to grave consequences and may actually result in ill-governance.

If the resolution professional replaces the board completely, there may be serious lapses in corporate governance:

(i) All matters which require decision-making by the board of directors [sec 179 (3) of the Companies Act and several other sections] will become meaningless;

(ii) Audit committee and other board committees will become meaningless;

(iii) Board responsibilities come on the IRP/RP who has a very narrow mandate in terms of time, and therefore, cannot be effectively replacing the long term functions of the board.

The right approach to adopt will be a temporary cessation of board powers, and placing the board under the control and supervision of the interim resolution professional/resolution professional.

The MCA as well as SEBI may consider issuing the following clarifications –

(i) During the insolvency resolution phase, the board/board committees shall function under the supervision and control of the resolution professional;

(ii) In terms of regulatory filings and authentication [for example, authentication of financial statements, quarterly financial statements, etc.], where authentication by the board is required, the same may be countersigned by the resolution professional as well;

(iii) All statutory duties and functions of whole time directors and managing director will continue to be discharged subject to the supervision of the resolution professional.

Therefore, the IBBI Circular that directs an insolvency professional to ensure corporate person undergoing any process under the Code complies with the applicable laws shall be read accordingly. It should be the responsibility of the KMPs and SMPs to continue to comply with the applicable laws and report periodically to the insolvency professional. The order passed in *M/s. Subasri Realty Private Limited (supra)* strengthens the view as stated above.
