Azadi Ka Amrit Mahotsav

सत्यमेव जयते

भारतीय दिवाला और शोधन अक्षमता बोर्ड

Insolvency and Bankruptcy Board of India

IBC

Evolution, Learnings and Innovation

2023

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Insolvency and Bankruptcy Board of India

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PREFACE

One of the pivotal pieces of legislation in India's legal framework is the Insolvency and Bankruptcy Code, 2016 (IBC/Code). It heralds a profound departure from the fragmented and often protracted insolvency processes that characterized the nation's financial landscape before its enactment. This legislation intended to provide an efficient and cohesive platform for addressing insolvency and bankruptcy matters across a spectrum of entities. In the realm of economic reforms, the IBC has earned its place as one of the most significant pieces of legislation in recent times. The IBC has completed the cycle of economic freedom by facilitating a smooth and efficient exit when circumstances dictate.

The IBC places a strong emphasis on resolution mechanisms driven by creditors, empowering financial creditors (FCs) and operational creditors (OCs) to initiate insolvency proceedings against a defaulting debtor. This shift to creditor-driven resolution has ushered in increased transparency and accountability.

The Code prescribes stringent timelines, requiring the completion of corporate insolvency resolution process (CIRP) within 180 days, with a one-time extension of upto 90 days in exceptional circumstances. It also provides for the CIRP to be mandatorily completed within a period of 330 days from the insolvency commencement date, including the time taken in legal proceedings in relation to such resolution process.This approach aims to minimize delays and optimise value for all stakeholders. Furthermore, the IBC highlights the significance of maximisation of value of assets of the corporate debtor (CD). It actively encourages the resolution of financially troubled firms, thereby preserving jobs and fortifying economic stability. In situations where revival is not a feasible option, the Code provides for a structured and transparent liquidation process.

The results from IBC can be assessed from the fact that, as of June 2023, out of a total of 6,815 initiated cases, closure has been achieved in 4,742 cases. Among the closed cases, 2,622 companies (55% of the total closures) were successfully rescued, while 2,120 cases resulted in liquidation. Among the rescued cases, 1,005 have been closed due to appeal, review, or settlement; 897 cases were withdrawn; and 720 cases have resulted in approval of resolution plans. Notably, 38% of the CIRPs resulting in resolution plans were earlier with the Board for Industrial and Financial Reconstruction and/or were defunct.

The Code's ability to present a credible threat, which is the possibility of a change in ownership for a CD, has resulted in a shift in debtors' behaviour. A number of debtors are proactively addressing financial distress at its nascent stages. They are taking steps to resolve issues when defaults are on the horizon, upon receipt of repayment notices, prior to the formal application filing, subsequent to application filing but before its formal admission, and even post-admission of the application. As per data from NCLT, the number of cases closed before admission (till May, 2023) stood at 25,565, which was 3.75 times higher than those (6,815 cases) admitted under the Code. Furthermore, it is worth noting that in the fiscal year 2023, the NCLT had approved 180 resolution plans, setting a record high. These approvals resulted in a collective recovery of ₹51,424 crore from resolved CDs.

The data as indicated above reflects the outcomes of the Code in terms of financial recovery. However, it is essential to recognize that the success of resolution goes beyond these recovery figures. To measure the impact of resolution process on rescued firms under the Code, the Indian Institute of Management, Ahmedabad (IIM Ahmedabad) was commissioned to conduct a study to review the functioning of firms that have undergone resolution under the Code. The Report of IIM Ahmedabad is now available in public domain. This Report looks at the performance of the firms both before and after the resolution process and finds that the IBC framework has yielded, for the resolved firms (i) increased sales, (ii) increased employee expense which could be attributed to increased employment generation, (iii) increase in assets, (iv) increased CAPEX, (v) threefold increase in market valuation of resolved firms (from ₹2 lakh crore to ₹6 lakh crore), and (vi) significant improvement in liquidity of these resolved firms. In a short span of 7 years, the IBC has, to a large extent, been able to achieve, what was expected of the landmark legislation.

Every economic law must remain responsive to emerging market dynamics and challenges to retain its relevance. The IBC is no exception and, as a crucial economic reform, it has rapidly evolved into a respected instrument, ushering in discernible changes in the prevailing credit culture of the nation. This marks the fifth consecutive annual release of the IBBI Publication, coinciding with the completion of seven years since its establishment. This Publication provides valuable insights that not only document the evolution of the Code and its associated institutions but also offer a comprehensive, interdisciplinary view of the Code's achievements, legal developments, and next generation reforms. It gathers the experiences and wisdom of individuals who have played integral role in the dynamic journey of implementing the Code. These contributors, including experts, professionals, stakeholders, academicians, researchers, and IBBI officials, have a wealth of knowledge to share, fostering thought-provoking discussions and enriching our understanding of this transformative process.

ThisPublication is divided into five parts. Articles included within Part I titled '**The Origin**' provide a narrative of stakes of FCs and OCs during the insolvency resolution process. The authors delve into the rights and obligations of the lenders as part of committee of creditors and contemplates untangling the two separate concepts and goes on to unveil the liability of legal heirs in personal insolvency framework under the Code.

In Part II '**Trends and Developments**', the authors analyse the issue of attachment of property of CD under various laws *vis-à-vis* ramifications under the IBC. The articles under this section explore the use of technology to facilitate the objectives of the Code and advocates the case for an integrated portal for resolution of insolvencies.

In Part III, titled '**The Cornerstones**', the authors put forth their views on the institutions created by IBC and provides recommendations for strengthening their role in furthering the objectives.

Part IV of the Publication titled '**Learnings and Outcomes**' provides an in-depth examination of the impact of IBC on credit markets, imparts valuable insights from real-world case studies involving pre-packaged resolution, aviation sector, sale as going concern cases, as well as analyses the entry routes available for investment in the Indian distressed assets market.

In Part V titled '**Entering New Horizons**', the authors have graciously contributed articles addressing group insolvency and cross-border insolvency matters, scope of mediation, data protection, crypto insolvencies, insolvency of data centres, environmental and social considerations in corporate restructuring and evolution of IBC Version 2.

The journey of the Code, characterized by numerous unforeseen twists and turns, has exhibited a consistent and progressive trajectory over the past years. What remains paramount is its ability to adapt and surmount the forthcoming challenges. The aspiration is for the Code's next five years to be more enriching and satisfying than the preceding ones, continuing its legacy of reforms and growth.

The IBBI expresses its gratitude to all the authors for generously sharing their valuable insights and expertise through their enlightening contributions to this publication. Continuous efforts of the Research Division at IBBI to bring out this publication are also appreciated.

Insolvency and Bankruptcy Board of India

Part I
The Origin

01

Financial Creditors and Their Stake in the IBC Process

- R. K. Bansal

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is the country's first comprehensive law to address the insolvency of corporate persons and individuals. The Code and the regulations have not only shifted the way the revival and reorganization of corporate companies (corporate debtor/CD) take place but has also ensured that the Code and regulations are amended from time to time to ensure that the initial hiccups and scenarios which were initially left unanticipated, are ironed out.

While the overall jurisprudence on the subject matter continues to evolve further, there have been instances that the issues which were already settled earlier either by legislation or judicial intervention comes up for reconsideration before the judiciary and the judiciary is compelled to hear it and pass its judgment on these issues, even though it may have been settled earlier.

The Bankruptcy Law Reforms Committee (BLRC) Report of 2015 highlighted the fact that the creditors of the CD are best suited to steer the revival process and address the issues concerning the CD during its revival. In fact, from the provisions of the Code, the importance bestowed upon the committee of creditors (CoC) in driving the corporate insolvency resolution process (CIRP) and liquidation is apparent. Financial creditors (FCs) feature on the top of the pyramid in any CIRP along with the workmen. This aspect of primacy for FCs in IBC had been put to rest by the Hon'ble Supreme Court in its landmark ruling in *Swiss Ribbons*[1] case wherein it was reiterated and asserted in no uncertain terms that the judiciary has no role to reverse or question the commercial wisdom of CoC except in few exceptional circumstances. Even with this well settled jurisprudence, with passage of time, the doors of the judiciary had to be time and again knocked to harp and bring out change in approach as regards this underlying philosophy of 'creditor driven' process on account of resistance from the various stakeholders including the promoters, minority stakeholders. Similar confusion and uncertainty arose consequent upon the *Rainbow Judgement*[2] wherein the basic understanding about nature and priority of government dues in the waterfall mechanism prescribed under section 53 of the Code was rewritten throwing open a fresh debate on the subject. Other such notable illustrations in this regard include judgements like in cases of *Jaypee Kensington*[3] *and India Resurgence*[4] etc. which once again brought to fore the lack of clarity on the status and entitlement of the secured creditors under IBC. All these rulings and developments have direct and serious bearing on the rights and recourse available to FCs. Below are some of these issues/challenges faced by FCs stage wise in the process of revival/liquidation of a CD.

CIRP STAGE

Delay in admissions/adjudication of section 7 applications

FCs, face a huge hurdle in the very threshold of initiation of CIRP, i.e., admission of applications under section 7 of the IBC before the Adjudicating Authority (NCLT/AA). According to a research paper titled 'Assessment of CIRP timelines', published by IBBI[5] in February, 2021, vide a survey conducted by IBBI, it has been found that more than 74% cases pending before NCLT take more than 90 days for admission under IBC. Furthermore, a consultation paper[6] released by the IBBI notes that the average time taken for admission of application for CIRP by an operational creditor (OC) has increased from 468 days in 2020-21 to 650 days in 2021-22. As per the article titled 'Concerns in insolvency' published in IBBI's Annual Publication for the year 2022 namely 'IBC – Idea, Impressions and Implementation',[7] a lot of petitions filed with the NCLT have been stalled at admission stage for up to two years.

In some cases, where an appeal is preferred before Appellate body and the order of AA is stayed, this period invariably goes well beyond one year. The Hon'ble Supreme Court in *Arcelor Mittal*[8] had clarified that the timelines under the Code are not mandatory. Unfortunately, this relaxation has ultimately led to release of pressure on NCLT to adhere to the timelines and above patterns of delays at admission or further CIRP stages has virtually become the prevalent norm.

One of the major reasons contributing to delay in admission of CIRP applications is NCLT asking for irrelevant information like, registration of certain transaction documents, inadequacy of stamp duty paid, claims by borrowers as regards their intention to negotiate settlement with the creditors, detailed statement of accounts, assessment of solvency status of the CD etc. Further, in certain cases, after completion of extensive hearings by NCLT on approval of resolution plan, the Bench is reconstituted thereby leading to resumption of hearing afresh which further consumes additional time and efforts.

It is pertinent to mention that incidence of default beyond a specified threshold was the only major criteria to be proved for admission of application under section 7 and once that default is established or discernible, no further scope of scrutiny and assessment by NCLT is required. However, the Supreme Court, in *Vidarbha Industries*[9] has ruled that the AA has the discretion to admit or reject despite existence of a default in certain circumstances. In the aftermath of the *Vidarbha* judgment, the admission process of an application under section 7 faced an additional burden of legal challenges along with the already existing other delaying factors in admission by the AA as discussed above.

Though the Hon'ble Supreme Court subsequently clarified that the *Vidarbha* judgment was case specific, it is not out of place to mention that every CD somehow tries to fit itself within the ambit of the facts and circumstances of the said judgment and a plea of dismissal of the application is accordingly prayed by such CD. The Hon'ble Supreme Court even recently in *M. Suresh Kumar Reddy v. Canara Bank*[10] held that there is no ground available to reject an application under section 7 of the Code, except when the NCLT finds that the debt has not become due and payable. It was further clarified by Supreme Court that the decision on *Vidarbha Industries* cannot be read and understood as taking a view which is contrary to the view taken in *Innoventive Industries*. This should put to rest many frivolous objections taken by CDs.

Delay in approval of resolution plan by AA

The delay in approval of resolution plans puts the resolution applicant (RA) off track, as the RA at the time of submitting the resolution plan may have the liquidity and the right business model to revive the CD. But due to ensuing delay, the RA sometimes lose out on funding or other strategic advantages. Further, it diminishes the value of the assets of the CD and ultimately, in many cases the RAs are constrained to back out on the resolution plan as they don't get the asset at the right time and value. According to IBBI Newsletter,[11] the average time taken from insolvency commencement date (ICD) as defined under section 5(12) of the Code to approval of resolution plan by AA (As on March, 2022) is 535 days (including the excluded time) and 451 days (excluding the excluded time). Brief data in this regard indicating overall delays during various stages before NCLT including ongoing CIRPs are given as under for ease of reference:

Table 1: Timelines - Ongoing CIRPs as of March, 2023

> 270 days	64%
>180 days ≤ 270 days	9%
> 90 days ≤180 days	12%
≤ 90 days	15%

Source: IBBI Quarterly Newsletter for the quarter January – March, 2023

Going by the above figures, on an average, it takes about one year for a CIRP to commence for the CD, and then another one year for the process to be fully completed. Therefore, what had to be completed in six months (as envisaged under the Code), roughly takes about two years. Thereafter, in case a resolution plan is to be implemented, there are again certain timelines to be adhered to, including timeline for payment of amounts envisaged under a resolution plan. Consequently, depending upon nature, type, and size of the industry /CD, it may take on an average a period of four years for an FC to attain recovery. However, even with above stretched timelines, a resolution under CIRP is superior as compared to conventional recovery mechanism like Debt Recovery Tribunal/ Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI)/liquidation considering that unlike pure asset sale route resorted to in other methods, CIRP addresses a stressed loan account in a much holistic manner since it maintains the going concern status of a CD.

LIQUIDATION PROCESS AND COMPLETION

A similar pattern is seen in passing orders for liquidation even in cases where the CoC has taken a call for taking the CD into liquidation. Besides in many cases despite issuance of the liquidation order, it takes many years before the assets are finally sold by the Liquidator, primarily due to multiple litigations initiated by multiple stakeholders including promoters against the liquidation sale. Brief data in this regard indicating overall delays during various stages before NCLT for liquidation are as under:

Table 2: Timelines - Ongoing liquidations as of March, 2023

<table>
<tr><td>> 2 years</td><td>55%</td><td rowspan="6">Out of all liquidation cases, 77% were referred from Board for Industrial and Financial Reconstruction most of which were already defunct at the time of reference to NCLT.</td></tr>
<tr><td>> 1 year ≤ 2years</td><td>19%</td></tr>
<tr><td>> 270 days ≤ 1 year</td><td>7%</td></tr>
<tr><td>> 180 days ≤ 270 days</td><td>6%</td></tr>
<tr><td>> 90 days ≤ 180 days</td><td>5%</td></tr>
<tr><td>≤ 90 days</td><td>8%</td></tr>
</table>

Source: IBBI Quarterly Newsletter for the quarter January – March, 2023

Liquidation process unlike the CIRP has many issues unresolved as regards treatment of the secured FCs and the jurisprudence on the same is also evolving and the judiciary often finds itself in crossroads *vis-a-vis* the Code and the laws prior to the enactment of the Code. The judiciary is forced to evaluate every aspect of the issue as to how the secured FCs were treated during the winding up era under the erstwhile Companies Act and how they are treated now under the Code, the reason for the same and the intent of the legislature. Some of the issues have been elaborated as under:

Secured creditors inter-se rights

The issue of *inter-se* position of the secured creditors during CIRP have been discussed and deliberated in various rulings, which were later fortified by amendment in the IBC (amendment to section 30 after *Essar Steels*[12] judgement). On the basis of the above developments, the legal position of entitlement of the secured creditors during CIRP was fairly settled. However, the waterfall provision prescribed for the liquidation stage as covered by section 53 of IBC has remained unaltered leading to continued confusion on the rights of the secured creditors during liquidation. It is pertinent to mention here that even though position under CIRP is comparatively clear, yet section 30 which deals with the issue during CIRP also refers to section 53 (liquidation value) which thereby results in discrepant interpretations for both CIRP as well as liquidation in as much as the rights and entitlements of secured FCs are concerned. The above issues have again cropped up prominently after last few judgements by the Apex Court on the subject, viz. *Jaypee Kensington*[13] *and India Resurgence.*[14] Before diving deep into the issues under challenge we may have a broad overview of the statutory landscape on the subject. Section 53 of IBC mainly lacks clarity on two spheres as explained hereunder:

53. Distribution of assets. –

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely: -

(a) the insolvency resolution process costs and the liquidation costs paid in full;

(b) the following debts which shall rank equally between and among the following:

(i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and

(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;....

(2) Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

Section 52 refers to the secured creditor who chooses to relinquish its security interest as mentioned hereunder:

(1) A secured creditor in the liquidation proceedings may—

(a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in section 53; or...

It may be observed that the wordings in section 53 are silent on the aspect of differential treatment of the various layers secured creditors, *viz.* 1st /2nd /subservient charge holders etc. which coupled with open ended powers given to the Liquidator as covered in section 53(2) above, leaves position of certain secured creditors precarious and open to interpretations.

In the banking industry, having exclusive charge on property is considered beneficial as in case of default by the CD and for securitization, the lender who has exclusive charge has superior recovery potential from the property sale. However, when the CD comes under CIRP, the same beneficial right which the lender had during the disbursal of the loan or while entering into contractual arrangements becomes an issue because most of the times the successful RA who come in may disregard such preferential rights of a secured FC and does not treat such lenders with equity. Sometimes when such secured FC is not one of the major FCs in the CoC, there is no special treatment given to such FC. Therefore, not only the asset is lost, but the FC does not get what is due to it either. Therefore, the issue of exclusive charge requires legislative intervention by way of an amendment, as the same invariably is challenged in court. When such FC having exclusive secured rights is in majority, it can resolve it favourably, but when the said FC is in minority, it is not heard and most of the times loses out in the process.

It is pertinent to mention the amendment made to section 30(4) of the Code which provides mechanism for distribution of proceeds out of resolution plan. According to amended provision, the manner of distribution may *'take into account the order of priority amongst creditors as laid down in section 53(1)'*, including the priority and value of the security interest of a secured creditor. However, the provision uses the term 'may' which makes the provision directory and not mandatory. Due to this, secured FCs may receive a value far less than the value of their security in a given case.

The above referred judgements have to a great extent diluted the entitlement of a given set of secured creditors of a CD undergoing CIRP/ liquidation under IBC. It is notable here that such a FC could have foreclosed such a security and recovered higher amount in normal course of laws prior to advent of IBC when such secured creditor would have carried out its credit analysis and decided to lend. An imminent outcome of such an approach would invariably lead to more liquidations, with every secured FC opting to stand on dissent. This will obviously defeat the very purpose envisaged by the Code.

Hence, it is advisable that a balanced approach is adopted whereby the rights and priorities of the secured FCs of any CD is given reasonable weightage while determining the *inter-se* distribution under a resolution plan, including exclusive, first, second or subordinate charge status, value of securities and other inter creditor arrangements. Such measures would be conducive for growth and stability of a healthy credit market in the long run.

Incidentally, this issue was under examination before the Insolvency Law Committee (ILC) in 2018 to suggest changes on this aspect to lend clarity. However, it was then not felt necessary by the ILC to bring out any changes in section 53 as the Committee felt the provisions coupled with jurisprudence on the subject was quite clear and adequate. Prior to that, even the BLRC Report of 2015 had also reiterated that the *inter-se* agreement between the creditors/lenders must be respected. However, absence of precise provisions under the Code led to continued uncertainty on the issue.

Status of government and statutory dues

The Government Authorities/Statutory departments claim huge amount of dues either in CIRP or before the Liquidator and in some cases, they become successful in obtaining a stay of the CIRP or liquidation proceedings or seeking orders that assets may be sold (in liquidation cases), but the unsettled dues of the government be kept open for consideration at a later stage. This creates issues in two ways. Firstly, in many cases, no buyer comes forth owing to the potential litigations/ encumbrances and secondly, the value of the property diminishes with time, as the Liquidator is not able to make the sale immediately. Also, liquidation doesn't happen due to such pending litigations because the Liquidator is duty bound to disclose these litigations in the offer document for sale.

The issue of treatment of security interests created by statutes has been dealt in *Rainbow Judgement*[15] where the Supreme Court while interpreting the definition of 'secured creditor' held that any government or governmental authority shall be a secured creditor as the charge created by a statutory law can be considered as a 'security interest'. Section 3(30) defines a 'secured creditor' as a creditor in favour of whom security interest is created. Further, 'transaction', as defined under section 3(33), includes an agreement or arrangement in writing to transfer assets, funds, goods, or services from or to the CD. The above definition under the Code denotes a security interest, created in favour of a secured creditor by a transaction, which secures payment of performance of an obligation. As such it primarily covers the 'transactions', created pursuant to a written agreement by the security provider. Thus, it is clear that the concept of security interest was intended to cover a mutually agreed transaction between parties leaving out deemed security creation on account of operation of law as propounded in the judgement. However, consequent upon the above ruling the well-established concept of security interest stands altered to much detriment of the FCs who are secured creditors.

It is pertinent to mention that as per the definition clause under the Code 'operational debt' means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority. Further as per section 53(1)(e)(i), the amounts due to the government comes low in priority under the waterfall mechanism.

Thus, it is expected that all government debts irrespective of whether they are secured creditors pursuant to a security interest created by a mere operation of statute or otherwise, are treated equally with other unsecured creditors. Further, it needs to be clarified that where the security interest is created pursuant to a transaction of the Central Government or a State Government with CD, the Government in question will be eligible to be treated as a secured creditor in the order of priority.

In the recently circulated notice[16] on changes proposed in IBC, it is being considered that all unsecured creditors (FCs, OCs and any Government or authority) other than the workmen and employees shall be treated equally for distribution under section 53. Accordingly, the order of priority for the secured creditors, workmen and employees shall be retained as stipulated under section 53.

Liquidation fees upfront to the Liquidator in case the FC stands outside liquidation

When a secured creditor decides to realise the asset outside the process of IBC and exercises this right under section 52 of the Code read with regulation 21A(2)[17] and section 53[18] of the Code, the secured creditor has to pay upfront the following to the Liquidator in its proportionate share:

- Insolvency resolution process costs (IRPC) and liquidation costs in full
- Workmen dues for a period of 24 months

As per regulation 21A, where the amount payable under this sub-regulation is not certain by the date the amount is payable under this sub-regulation, the secured creditor shall pay the amount, as estimated by the Liquidator. Regulation 21A(3)[19] states that if the secured creditor fails to make payment of IRPC and liquidation cost as provided in section 53(1)(a) and the workmen dues provided in section 53(1)(b)(i) within 90 days, the asset which is subject to security interest shall become part of the liquidation estate.

Therefore mandatorily, IRPC, liquidation cost and workmen dues for a period of 24 months is required to be paid within 90 days in case a secured creditor decides to realise the secured asset outside liquidation.

The above regulations under the IBBI (Liquidation Process) Regulations, 2016 makes it extremely difficult for the secured FCs to take a stand of whether they want to stand in liquidation or outside, the secured FC has to make payments to the Liquidator upfront even before making a sale, therefore the secured FC stands high and dry, as it is possible, the FC may not get a buyer immediately, therefore despite being higher in the scheme of stakeholders, the FCs have to make upfront payment without any surety that the secured asset may be sold or not.

Provident fund and gratuity dues

Another issue that stands unresolved is the treatment of employees' dues in the nature of provident fund (PF) and gratuity during liquidation. The Supreme Court in an order delivered in February, 2023 in *Moser Baer Karamchari Union*[20] upheld the judgment of NCLT which held that PF and gratuity dues does not form part of liquidation estate and cannot be recovered under section 53 of the Code which provides for waterfall mechanism. Therefore, PF and gratuity dues do not form part of the liquidation estate of the CD and it cannot be used for distribution under section 53 of the Code.

The Chennai Bench of National Company Law Appellate Tribunal (NCLAT) in *Mrs. C.G. Vijyalakshmi v. Shri Kumar Rajan*[21] while placing reliance on the earlier judgment of the NCLAT in *Jet Aircraft Maintenance Engineers Welfare Association*[22] decided upon the treatment of PF and gratuity during the CIRP and held that both the dues are to be paid in full to the workmen/employees till the CIRP commencement date.

Under section 53 of the Code, reference to workmen dues under the IBC is with respect to the meaning ascribed to workmen under section 326 of the Companies Act, 2013 and as per the said provision, workmen dues include PF and gratuity payable to the workmen. Subsequently, with the enactment of the Code, sub-section (7) was added to section 327 of Companies Act, 2013 to state that sections 326 and 327 shall not be applicable in the event of liquidation under the Code, therefore the waterfall provided under sections 326 and 327 shall not apply to the proceedings under IBC. As such the waterfall provided only in section 53 of the Code has to be followed in case of liquidation under IBC. Therefore, as per the amendment, it was inferred that section 326 is only relevant for ascertaining what are workmen dues whereas section 53(1)(b)(i) provides for workmen dues to be paid in full for the period of two years preceding the liquidation commencement date.

However, considering above judgements including *Jet Airways* judgement of the NCLAT which was also upheld by the Supreme Court, PF, gratuity etc. have priority and were expected to be paid in full in the CIRP and not merely for the period of two years preceding the liquidation commencement date. The above rulings further complicate the status of secured FCs as there is no clarity whether in cases where a secured FC decides to realise the asset outside liquidation has to pay upfront to the Liquidator the workmen dues including PF and gratuity dues in full along with the other costs stated by the Liquidator as there is no judgment or clarity on the point. This issue stands open ended for any possible interpretation.

OTHER ISSUES RELATED TO THE PROCESS UNDER THE CODE

Low realisation ratio

According to IBBI Newsletter,[23] the FCs recovered 30.84% of their claims, which only reflects the extent of value erosion by the time the CDs entered CIRP. Lower realisations push the FCs towards other modes of recovery provided under the law such as SARFAESI. Other modes may benefit the individual FC but from the point of economy and banking industry, the Code is the best mode for resolution as it helps in maintaining the business of CD as a going concern and in preservation of organisational capital (to which no value can be assigned). If a business survives, it ultimately helps the FCs by creation of additional demand for credit in the market.

Poor turnout on avoidance application

Avoidance transactions hold tremendous value and can greatly enhance the value realisations by the FCs. These applications continue independently of the CIRP/liquidation and therefore, assume lower significance. In most of the cases, the process under the Code gets completed and these applications continue to remain pending before the Courts.

According to IBBI Newsletter,[24] 871 applications (involving ₹2.85 lakh crore) seeking avoidance of transactions have been filed with the AA till March 31, 2023. Out of this, only 163 applications have been disposed, clawing back only ₹5215.10 crore.

Recently, Delhi High Court in *Venus Recruiters*[25] held that cases where treatment of benefit acquired from avoidance transactions could not be accounted for in resolution plans, such benefit would accrue to the creditors. Therefore, if these applications can be expedited, it will benefit FCs the most.

Inadequate infrastructure

Due to insufficient strength of NCLT members, fewer benches across India, coupled with entertaining frivolous applications by NCLT, the backlog of cases and extent of delay in disposal of cases by NCLT has been on a rise over the years. Also, the optimum composition of technical and judicial members who can deal with all type of cases in all benches is missing, leading to unreasonable load on few benches. Further, the cases under IBC are not the only mandates of the NCLT, they also consider various cases under the Companies Act, 2013 such as mergers, oppression and mismanagement, etc. This often leads to delays in the commencement and conclusion of the CIRP/liquidation. According to a reply filed by the Ministry of Corporate Affairs (MCA) pertaining to a question asked in Lok Sabha, 21205 cases were pending with NCLT benches as on January 31, 2023 including a whopping 12963 cases under IBC.[26]

CONCLUDING REMARKS AND WAY FORWARD

Even with the above issues, the Code continues to remain the most viable solution for a CD in distress to revive itself or to liquidate and aim for value maximization. With the emphasis of the judiciary and the legislature being revived, the major onus for striking a perfect balance in the whole process falls primarily on the shoulders of the FCs. The FCs holds a fiduciary position *vis-a-vis* the CD and other stakeholders and dons the role of a facilitator for revival. Therefore, it is high time that some decisive measures are taken to ensure that their basket of rights and entitlements under the insolvency regime is not unduly diluted. Adequately addressing the issues highlighted above can go a long way in improving the status of FCs. Some of such measures could be as under:

- NCLT may strictly confine to its jurisdictional area and avoid straying into unrelated areas like going into solvency levels of CDs besides other such issues.
- Mandatory timeline may be specified in consultation with judiciary for disposal of various applications/appeal by NCLT/NCLAT either at the admission stage or at the plan approval stage.
- Express provisions should also be brought in the Code/regulations discouraging filing of frivolous applications by various parties, especially the promoters/related parties. Steep cost and penalties may be prescribed against such frivolous applications and once having been penalised on this line, they should be barred from instituting further such applications.
- Deeming provisions may also be considered for delays beyond a specific threshold.
- Disincentives in form of bar from raising further credit or acquiring directorship or floating other ventures may be contemplated in line with as in case of wilful defaulters.
- Another measure could be requirement of deposit of certain amounts being percentage of defaulted amount to be deposited just like in case of appeal in Debt Recovery Appellate Tribunal.
- Further tightening of process may include stipulation that any such objections can be raised only once within seven days of application which application must be disposed of in further seven days.
- After approval by CoC, NCLT to invariably approve it within specified timeline or deemed approval (though Supreme Court has already ruled on this line, but not adhered to by NCLT).

- Besides upon failure of CIRP, liquidation of a CD should be ordered promptly once CoC has passed resolution to this effect.

As the Code is the flagship economic legislation by the Government, despite all the challenges and issues cropping up in its implementation, the Government has time and again stood up to cure the ambiguities present in the Code. This intent on the part of legislature is of utmost significance to let the Code survive the uncertain future. The success of the Code is also visible in the encouraging reduction in the share of non-performing assets in the banking system. As highlighted by the former Chairperson of IBBI, Dr. M.S. Sahoo, *'an economic law is essentially empiric, and it evolves continuously through experimentation and the Code is no exception'*.[27] The Code has undergone six legislative amendments since its operationalisation to make it closer to realities of the day. We must not fall in trap by judging the outcomes of the Code based on its brief journey, there is still a lot to achieve.

In this context it is pertinent to mention that MCA has floated a discussion paper in January, 2023[28] wherein various amendments in the Code have been proposed including in relation to the admission of CIRP applications, streamlining the insolvency resolution process, recasting the liquidation process, and the role of service providers under the Code etc. The recommendations made in the said discussion paper touches upon various open issues as discussed hereinbefore including very contentious issues like the distribution of proceeds and the concerns regarding inequitable distributions amongst the creditors.

It is to be seen how the legislature finally plays out the whole scheme and how it further strengthens the overall functioning of the Code vis-a-vis the CD and its various stakeholders. Given the way the Code has evolved over the years through various channels and forces, it can definitely be hoped for an equitable proposition for all concerned.

[1] *Swiss Ribbons Pvt. Ltd. v. Union of India,* Writ Petition (Civil) No. 99 of 2018.

[2] *State Tax Officer v. Rainbow Papers Ltd.*, Civil Appeal No. 1661 of 2020.

[3] *Jaypee Kensington Boulevard Apartments Welfare Association & Ors. v. NBCC (India) Ltd. & Ors.*, Civil Appeal No. 3395 of 2020.

[4] *India Resurgence ARC Pvt. Ltd. v. M/s Amit Metaliks Ltd.*, Civil Appeal No. 1700 of 2021.

[5] Shikha N. and Shahi U. (2021), "Assessment of Corporate Insolvency & Resolution Timelines", IBBI website, February, 2021.

[6] IBBI (2022), "Consultation paper on issues related to reducing delays in the corporate insolvency resolution process", 13th April 2022.

[7] IBBI's Annual Publication 2022, "IBC- Ideas, Impressions and Implementation", October, 2022.

[8] *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta & Ors.*, Civil Appeal No. 9402-9405 of 2018.

[9] *Vidarbha Industries Power Limited v. Axis Bank Limited,* Civil Appeal No. 4633 of 2021.

[10] *M. Suresh Kumar Reddy v. Canara Bank,* Civil Appeal No. 7121 of 2022.

[11] IBBI Quarterly Newsletter, January-March 2023, Vol. 26.

[12] *CoC of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors.*, Civil Appeal No. 8766-67 of 2019.

[13] Supra Note 3.

[14] Supra Note 4.

[15] Supra Note 2.

[16] MCA discussion paper, "Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code 2016", 18th January 2023.

[17] Regulation 21A(2): Relevant portion being reproduced for ease of reference:

> 21A(2) Where a secured creditor proceeds to realise its security interest, it shall pay - (a) as much towards the amount payable under clause (a) and sub-clause (i) of clause (b) of sub-section (1) of section 53, as it would have shared in case it had relinquished the security interest, to the liquidator within ninety days from the liquidation commencement date; and (b) the excess of the realised value of the asset, which is subject to security interest, over the amount of his claims admitted, to the liquidator within one hundred and eighty days from the liquidation commencement date.

[18] Section 53 of the Code: Relevant portion being reproduced for ease of reference:

> (a) the insolvency resolution process costs and the liquidation costs paid in full.
>
> (b) the following debts which shall rank equally between and among the following: (i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52.

[19] Regulation 21A(3): Relevant portion only reproduced:

> (3) Where a secured creditor fails to comply with sub-regulation (2), the asset, which is subject to security interest, shall become part of the liquidation estate.

[20] *State Bank of India v. Moser Baer Karamchari Union & Anr.*, Civil Appeal No. 258 of 2020.

[21] *Mrs. C.G. Vijyalakshmi v. Shri Kumar Rajan, Resolution Professional & Ors.*, Company Appeal (AT) (CH) (Ins.) No. 29 of 2021.

[22] *Jet Aircraft Maintenance Engineers Welfare Association v. Ashish Chhawchharia,* Company Appeal (AT) (Ins.) No. 752/2021.

[23] Supra Note 11.

[24] *Ibid.*

[25] *TATA Steel BSL v. Venus Recruiters,* Letters Patent Appeal No. 37 of 2021.

[26] Parliament of India (Lower House), Unstarred Question No. 2049 (17th Lok Sabha, Session XI), Answered on March 13, 2023

[27] Kelkar N. (2021), "We must assess IBC's success in relation to its objective, which is reorganisation", *The Week,* 8th October.

[28] Supra Note 16.

02

Moving Towards Improved Rights of Operational Creditors under the IBC – An Analysis

- R. Shankar Raman

INTRODUCTION

Prioritisation of debts in liquidation, often referred to as the 'liquidation waterfall mechanism', is regarded as one of the most important tenets of insolvency law across the world. The manner of operation of the liquidation waterfall has evolved through years of jurisprudence and quite simply, describes the order of priority in which assets will be distributed amongst the various stakeholders of a liquidating company. As stakeholders get paid sequentially with each stakeholder taking his share from funds and assets remaining after higher-ranking creditors have received payment, the order of distribution of liquidation assets is instrumental in determining not only how much of the liquidation assets a stakeholder will receive, but also, whether a particular stakeholder will eventually be entitled to anything at all.

In India, section 53 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) describes the waterfall mechanism for distribution of assets on liquidation of a company. Once the insolvency resolution process costs and liquidation costs have been paid in full, the workmen's dues for a period of 24 months preceding the liquidation become payable, and thereafter dues to secured creditors, if such creditors have relinquished their right to enforce the available security. Employees' dues (other than workmen) for 12 months preceding liquidation come next, following which financial debts owed to unsecured creditors become payable. In the fifth position are government dues (unless secured by operation of law) and dues to secured creditors, for any amount remaining unpaid after enforcement of security interest. Remaining debts and dues (which include unsecured operational debts) come in the sixth position, just before preference shareholders and equity shareholders, who take the last share.

Notably, the Code makes a two-fold distinction in relation to the distribution of liquidation assets, firstly, in relation to the nature of the debt, i.e., whether a debt is secured or unsecured and secondly, in relation to the nature of the stakeholder, i.e., whether the creditor is an operational creditor (OC) or a financial creditor (FC). For secured debt, the Code does not distinguish between whether such debt is due to an OC or a FC, and secured debt to both these types of creditors may be paid simultaneously. However, for unsecured debt, unsecured FCs are ranked higher in the fourth place over unsecured OCs who take sixth place in the hierarchy of the liquidation waterfall and are paid only after FCs and government dues have been paid.

FCs and OCs

The Code defines a FC as '*a person to whom a financial debt is owed, including a person to whom such debt has been legitimately assigned or transferred*'.[1] However, for a FC to fulfil the requirements of the above definition, the nature of the debt owed to him must fall within the purview of a 'financial debt' under the Code. A 'financial debt' in this context is '*a debt together with interest, if any, that is distributed against the consideration for time worth of money*'.[2] The said definition includes within its fold money borrowed against interest payment, money raised under an acceptance credit arrangement and sums raised by note purchase facility, or through issuance of bonds, notes and debentures.[3]

An OC on the other hand is defined as '*any person to whom an operational debt is owed, including any person to whom such debt has been legally assigned or transferred*'.[4] In this context, an 'operational debt' is defined as '*a claim for the provision of goods or services, including employment, or a debt for the repayment of dues arising under any law for the time being in force and payable to the Central Government, or a local authority*'.[5]

From the above description, a FC is one whose relationship with the liquidating entity arises from a financial contract such as a loan or a debt security whereas an OC's rights in relation to a transactional or business debt arises out of the business operations of the liquidating entity. This bifurcation of rights of creditors under the Code based on whether they belong to the financial or operational category has been noted by the Supreme Court of India in *Swiss Ribbons Pvt. Ltd. v. Union of India,*[6] where the Court has held that FCs finance a term loan or a working capital enabling a corporate debtor (CD) to incorporate or operate its business. Contracts with OCs in contrast relate generally to supply of goods and services in the operation of business, therefore typically involving a lesser sum of money than a financial debt.

RIGHTS OF OCs AND FCs DISTINGUISHED

The Code contains several distinctions between the treatment accorded to the rights of FCs and OCs. For one, OCs do not form part of the committee of creditors (CoC) which is empowered to take important decisions regarding the acceptance or rejection of an insolvency resolution scheme. OCs having aggregate dues not less than 10% of the outstanding debt of the debtor entity are allowed to attend the meetings of the CoC without however, being entitled to vote.

From a reading of the Report of the Bankruptcy Law Reforms Committee published by the Insolvency and Bankruptcy Board of India (IBBI/Board) in 2015,[7] it appears that exclusion of OCs from membership of the CoC arises from the expectation that members of the CoC must be creditors having capability to assess viability, as well as the willingness to modify the terms of existing liabilities in negotiations. Since FCs are inherently better positioned than OCs to decide on matters concerning viability or insolvency of the liquidating entity and to negotiate and/ or take the risk of postposing payments, they are better suited as members of the CoC than OCs. Additionally, OCs may be diversified and numerous in number, making it challenging to obtain their votes on a resolution plan. This further strengthens the argument for their exclusion from the CoC.

The Code also makes a distinction in the manner of payment of liquidation assets between FCs and OCs with FCs being placed higher on the liquidation waterfall mechanism than OCs, as mentioned above. This differentiation in the insolvency process is questionable, since contractually, FCs and OCs appear to be on equal standing and any discrimination between the two may be contrary to the principles of natural justice and equality. It can be contended that since supply of goods and services on credit is an integral part of a business, the same contributes towards the working capital available to the debtor entity, further minimising the difference between FCs and OCs. Additionally, placing FCs on a higher pedestal in the liquidation waterfall may result in prospective goods and service providers exhibiting disinterest in entering into business on credit with micro, small and medium enterprises (MSMEs), having regard to the fact that preference will be given to the financial lenders of the MSME in the event of an insolvency event concerning the MSME.

To address such concerns, the Code and the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) have been amended in the past few years to accord specific protection to OCs. An insolvency resolution plan is presently ineligible for approval under section 31 of the Code unless a minimum payment equivalent to the liquidation value is made available to the OCs under section 30(2) of the Code read with regulation 38(1) of the CIRP Regulations. Liquidation value refers broadly to value that the OC would be entitled to in a liquidation event under the liquidation waterfall under section 53 of the Code, if the company were to be liquidated on the insolvency commencement date. Explanation 1 to section 30(1)(b) of the Code further provides that distribution of liquidation assets in accordance with the provisions of the said clause shall be fair and equitable to the creditors. In view of the same, National Company Law Tribunal benches are mindful of whether OC's rights are sufficiently protected before evaluating the viability or feasibility of any insolvency resolution plan. The above amendments to the provisions of the Code and the regulations have strengthened OC's rights under the Code, especially during the insolvency resolution process.

Nevertheless, it appears that some distinction between the rights of FCs and OCs continues to remain in relation to liquidation payments under section 53 of the Code. Be that as it may, the Supreme Court of India has upheld the constitutional validity of the liquidation waterfall mechanism contained in section 53 of the Code on the ground that it fulfils the ultimate objective of the Code, i.e., maximising the value of

CD's properties while balancing the interests of all stakeholders.[8] The Court has however clarified that the priority sequence mentioned in section 53 of the Code will be applicable only during the liquidation pay-outs but not during the actual corporate insolvency resolution process (CIRP).

A third distinction between the rights of FCs and OCs under the Code relate to the right to commence CIRP against the CD. In accordance with section 7(1) of the Code, a FC may file an application to commence a CIRP against a CD on the occurrence of an event of default. The Adjudicating Authority (AA) is required to ascertain the existence of the default within 14 days from the date of receipt of the application.

For OCs, the right to commence a CIRP is contained in sections 8 and 9 of the Code and becomes dependent on the absence of a pre-existing dispute between the OC and the debtor. On the occurrence of a default, the OC has the right to send a demand notice to the CD of the unpaid operational amount, together with an invoice seeking payment of the defaulted amount. The CD is required to either make payment of the unpaid operational debt or bring to the notice of the creditor the existence of a dispute within 10 days from the receipt of the demand notice from the creditor. If neither payment nor notice of a dispute stating that payment is already made by the debtor is received from the CD with a period of 10 days from the date of delivery of the demand notice, the OC may submit an application for the commencement of insolvency resolution proceedings.

EXISTENCE OF A PRE-EXISTING DISPUTE NECESSARY

Under section 9 of the Code, the AA is bound to reject an application by an OC for initiation of CIRP, even if it is complete in all aspects, if a notice of dispute has been received by the OC before making the application or if there is a record of dispute in the Information Utility.[9] The notice of dispute must bring to the attention of the OC or the existence of a 'dispute', which term has been defined in the Code to include a pending suit or arbitration proceeding between the parties.[10]

The term 'dispute' is defined in section 5(6) of the Code to include a suit or arbitration proceedings relating to the existence of the amount of debt; the quality of goods or service; or the breach of a representation or warranty.

The term 'existence of a dispute' arose for consideration at the first instance before the National Company Law Appellate Tribunal (NCLAT) in *Kirusa Software (P) Limited v. Mobilox Innovations Pvt. Ltd.*[11] The NCLAT held that the definition of 'dispute' is 'inclusive' and not 'exhaustive' and has wide connotation, including within its fold, disputes in relation to the amount of debt, quality of goods or services and/or breach of a representation or warranty. The NCLAT further observed that a 'dispute' as defined in the Code cannot be limited to the ambit of a pending suit or arbitration proceedings only and would mean and include any proceedings initiated and pending under any law in force, including under the Civil Procedure Code, 1908, the Companies Act, 2013 and the Sale of Goods Act, 1930.

On appeal, the Supreme Court of India *in Mobilox Innovations Private Limited v. Kirusa Software Private Limited* (Mobilox Innovations)[12] elucidated that so long as a genuine dispute exists, the AA is bound to reject the application for initiation of insolvency resolution proceedings by an OC. It is noteworthy that a 'genuine' dispute was described as one which is bona fide and truly exists in fact, and is real, not spurious, hypothetical, illusory or misconceived. Effectively, the Supreme Court of India made it clear that any real dispute regarding payment between the OC and the debtor, which can be reconciled within the inclusive definition of 'dispute' under the Code, and which was pre-existing, i.e., notice of which was received before filing the application for initiation of insolvency proceedings, would render such application by the OC liable to be rejected.

The *Mobilox Innovations* judgement has since been relied on by courts in several instances and seemed to place an embargo on the filing of insolvency resolution applications by OCs for extraneous considerations or as a substitute for debt enforcement procedures. The mere fact that the concerned CD is challenging an arbitral award against it would be sufficient to connote that it disputes the said award. Therefore, in so far as OCs are concerned, the right to initiate insolvency proceedings seemed to arise only in clear cases where a clear dispute between the parties in relation to the debt did not exist.

The meaning accorded to an 'existing dispute' was further widened and consequently, the right of OCs to initiate insolvency resolution processes even more limited by the few decisions of the Supreme Court of India following the *Mobilox Innovations* judgement. In *Kay Bouvet Engineering Ltd. v. Overseas Infrastructure Alliance (India) Pvt. Ltd.* (Kay Bouvet),[13] the Supreme Court of India redefined the scope of a pre-existing 'dispute' under section 9 of the Code by deciding that the mere existence of any dispute between the OC and the debtor can be a ground to reject the insolvency resolution application. The Court explained that it will not examine the merits of a dispute under section 9 of the Code other than to see if the same is a genuine dispute and restricted the meaning of a 'genuine' dispute to an ascertainment from the court that the dispute is not plainly vexatious or frivolous.

Notably, in *Rajratan Agarwal v. Solartex India Pvt. Ltd.* (Solartex),[14] the Supreme Court limited the scope of interference by courts while considering the nature of the dispute raised by a debtor against the OC and opined that the standard of determining an existing dispute under the Code ought not to be equated with the 'Doctrine of Preponderance of Probability' in civil suits. The Doctrine of Preponderance of Probability finds its roots in the definition of the term 'proved' in section 3 of the Evidence Act, 1872 which states that '*a fact is said to be proved, when after considering the matters before it, the Court either believes it to exist, or considers its existence so probable that a prudent man ought, under the circumstances of the particular case, to act upon the supposition that it exists*'. In simple parlance, the doctrine stipulates that courts faced with conflicting views in relation to existence of a fact, will believe that the particular fact exists if it is of the view that a prudent man faced with a similar conflict, will find on weighing probabilities, that preponderance is in favour of the existence of the fact.

Placing reliance on the *Mobilox Innovations* judgement, the Supreme Court observed that it would be enough to ascertain whether a dispute exists between the parties, which may arise even after acceptance of goods and service by the debtor and that the Code does not envisage that an OC will initiate the insolvency resolution process over small amounts of default. For this reason, the Court opined that the standard with reference to which a case of pre-existing dispute is employed under the Code cannot be equated with the principle of preponderance of probability which guides a civil court at the stage of decreeing a suit.

Through the *Kay Bouvet judgement* and the *Solartex judgement*, the Apex Court has set a higher benchmark for judicial scrutiny in relation to making insolvency resolution applications by OCs under the Code.

However, the NCLAT, while delivering its recent decision in *Krishna Hi-Tech Infrastructure Private Limited v. Bengal Shelter Housing Development Limited*,[15] has taken a slightly different approach towards the interpretation of a 'dispute' under section 9 of the Code. It has observed that one of the questions which needs to be considered while deciding on the existence of a pre-existing dispute is whether the objection raised by the CD opposing the claim of the OC is a 'moonshine defence' or a dishonest/sham defence. The NCLAT clarified that in the facts of the present case, since the debtor had received the goods from the OC without raising any dispute or objection, the defences being raised by the debtor subsequently can be termed as a 'moonshine defence', which ought not to be accepted by the Tribunal. In the end, the NCLAT further elaborated that it is essential to see that a real and genuine dispute pre-exists between the parties for the application of the CD to be rejected under section 9 of the Code.

It is interesting to note the ever-developing legal position in relation to interpretation of 'pre-existing disputes' between CDs and OCs and consequently, on the right of CDs to initiate insolvency proceedings. The *Kay Bouvet judgement* and the *Solartex judgement* portray a drastic stance with regard to the unwillingness of courts to delve into the merits of a dispute between the OCs and CDs, holding instead that existence of the dispute is sufficient to reject an OC's application for CIRP. However, legal landscape seems to be evolving with the decision of NCLAT in *Krishna Hi-Tech Infrastructure* and its preclusion of 'moonshine' defences by the CD.

CONCLUSION

It is worth noting that in recent years, many OCs have been able to recover their debts through the Code after following the procedure notified in the Code. There appears to be a judicial and legislative trend in recent years towards balancing the rights of OCs with those of FCs under the Code.

It must be remembered that the purpose of implementing the Code is to rehabilitate and revive the CD to a point that it can do business on its own. The liquidation process is not intended to be a replacement for the resolution process but rather a final resort only if the settlement process fails. In this context, it is important to ensure that all creditors, whether FCs or OCs, have a fair chance at recovering their dues in the CIRP.

[1] Section 5(7) of the Code.
[2] Section 5(8) of the Code.
[3] *Ibid.*
[4] Section 5(20) of the Code.
[5] Section 5(21) of the Code.
[6] [2019] SCC Online 73.
[7] Report of the Bankruptcy Law Reforms Committee, Vol. 1, November, 2015, p. 84.
[8] [2019] SCC Online 73.
[9] Section 9(5)(2)(d) of the Code.
[10] Section 8 read with section 5(6) of the Code.
[11] Company Appeal (AT) (Insolvency) 6 of 2017.
[12] [2018] 1 SCC 253.
[13] Civil Appeal No. 1137 of 2019.
[14] Civil Appeal No. 2199 of 2021.
[15] C.P (IB) No. 1289/KB/2019.

03

Creditor Rights Vs. CoC Duties: Untangling the Two

- Pooja Singla and Ritesh Kavdia

'Being willing makes you able'

- Rhonda Britten

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) represents a reform of unparalleled magnitude in numerous aspects. Serving as a notable departure from previous systems, it consciously establishes a policy where control of a company's affairs is transferred to creditors in the event of failure to repay debt.[1] Also, in the past, laws in India had brought legislature, executive or judicial arms of the Government, into deciding the fate of the distressed firms. In contrast to this, the Bankruptcy Law Reforms Committee (BLRC), which formulated the Code, expressed that the appropriate disposition of a defaulting firm is a business decision, and only creditors should make it.[2] Consequently, the IBC marked a significant transformation, reshaping the country's approach to handling insolvency resolution, bringing along with it the newfound empowerment of creditors, granting them unprecedented control over the insolvency resolution process.

Possessing significant power entails a significant responsibility. It is not out of place to impose requirements regarding competence and character on an authority when entrusted with such responsibilities. While proposing the institution of committee of creditors (CoC) as a supreme decision-making body in the insolvency proceedings, the BLRC and subsequently IBC addressed some concerns as regards suitability of the participants in the CoC. For instance, the Committee observed that members of the CoC need to have the capability to assess viability of resolution as well as need to be willing to modify terms of existing liabilities, hence the financial creditors (FCs) were considered better equipped to make informed business decisions for the distressed corporate debtor (CD).[3] Also, the Code excluded the related parties of the CD from the CoC, even if the CD had financial debt owed to them, so as to avoid any conflict of interest.[4] The BLRC also proposed that if a creditor chooses not to participate in the negotiations, despite having been so informed, the vote of CoC will be calculated without the vote of this creditor.[5] However, the Code has been enacted with a voting threshold requirement that does not exclude abstaining creditors. This implies that fulfilling the function as a part of the CoC is not optional for FCs.

Over the last more than six years of implementation, the supremacy of the commercial wisdom of the CoC in the relevant matters has been well established with jurisprudence. However, on several occasions the Adjudicating Authority (AA) has raised concerns regarding the conduct of the CoC in the insolvency proceedings. In its discussion paper dated August 27, 2021, the Insolvency and Bankruptcy Board of India (IBBI) proposed to enforce a Code of Conduct as guidelines for participating members in a CoC.[6]

While a need has been felt to device an appropriate mechanism to effectively guide the CoC for its functioning, it is yet to come as regulation or guideline. The proposed guidelines seem to be equally applicable to those creditors who are not willing to effectively participate in the CoC. This article delves into the rights and obligations of the creditors as part of CoC and contemplates the constitution of CoC with only those creditors who willingly volunteer for it, thus separating the rights and obligations of creditors.

CONSTITUTION AND ROLE OF COC IN INSOLVENCY PROCEEDINGS

The CoC plays a crucial role in the corporate insolvency resolution process (CIRP). Comprising all FCs of the CD, the CoC is responsible for various duties and responsibilities under the Code. One important aspect is the composition of the CoC, which includes all the FCs of the CD. The related parties of the CD are, however, not permitted to have representation, participation, or voting rights in the CoC meetings.[7]

The CoC carries out a range of obligations and tasks. Its first and foremost responsibility is to designate a Resolution Professional (RP) within 30 days of the Interim Resolution Professional (IRP) being appointed. The CoC has the option to either confirm the IRP as the RP or select a new RP to assume control of the CD and oversee its operations.[8] While the powers of the Governing Board of the CD are vested in the RP, the Code lists an array of functions that require the prior approval of CoC. It includes important functions like raising of interim finance, creating any security interest over any asset of the CD etc.[9]

One of the other key roles of CoC is to evaluate and approve resolution plans submitted by prospective resolution applicants. The CoC evaluates the feasibility and viability of the resolution plans and approves the most suitable plan with a vote of at least 66% voting share.[10] The CoC also has the power to take decision to liquidate the CD, any time after its constitution but before the confirmation of the resolution plan.[11] Needless to say, the CoC has the power to negotiate with the resolution applicants to modify their plans to better suit the interests of the stakeholders. The supremacy of the commercial wisdom of CoC first gained traction with the February, 2019 order of Hon'ble Supreme Court in the matter of *K. Sashidhar v. Indian Overseas Bank & Ors.*,[12] wherein it was held that the legislature has not endowed the AA with the jurisdiction or authority to analyse or evaluate the commercial decisions of the CoC. The crucial role of CoC was further discussed in detail in the matter of *Committee of Creditors of Essar Steel India Limited Through Authorised Signatory v. Satish Kumar Gupta & Ors.*,[13] wherein Hon'ble Supreme Court held that the AA cannot interfere with the commercial decision taken by the CoC, and the limited judicial review available has to be within the four corners of section 30(2) of the Code.

It is, hence, clear from the aforesaid judgments that the commercial wisdom of the CoC is of paramount importance during the insolvency proceedings. It is also important to note that the decisions of CoC affect not only its constituents, but other stakeholders like, operational creditors (OCs), workmen, employees. In addition to its decision-making role, the CoC also acts as an interface between the CD and other stakeholders such as the IRP, RP, the AA, OCs and other creditors. Overall, the CoC plays a crucial role in the resolution process of a distressed CD, by ensuring that the interests of all creditors are protected and that a feasible and viable resolution plan is approved. Its role as a decision-maker and interface between stakeholders is crucial in ensuring that the resolution process is completed in a timely and efficient manner.

EXCLUSION OF RELATED PARTIES

There is a belief that creditors as a group prefer collective process to resolve bankruptcy than to a grab race among themselves particularly when such a race may cause the demise of a viable going concern.[14] In his article, Barry E. Adler argues that the reason why a collective process is considered superior is because individual creditors, left to their own whims, are motivated to act solely in their own interests, even when their interests may directly conflict with the creditors' collective interests as a group.[15]

The IBC provides for a CoC controlled process to resolve insolvency. The Code provides for the IRP to constitute a CoC comprising of all FCs, after collation of the claims received against the CD. However, the related party FCs, though included in the list of creditors (and their claim considered in the total claim amount), are excluded from the CoC and thus are not given any right of representation, participation or voting in meetings of the CoC.[16]

The insolvency regime under the Code is designed to reduce the possibility of allowing some stakeholders to benefit at the expense of others. When considered in respect of the related parties of the CD, if these are given the power to control the decisions regarding its insolvency resolution, they may choose to do so in a manner that would unfairly benefit the erstwhile management of the CD. In other words, there is a concern that related party creditors would not be able to act independently.[17] The intent of section 21(2) of the Code in denying voting rights to related parties is to ensure that the CIRP is driven by external creditors. Even though related parties may have claims, and may even file for the CIRP, such parties cannot drive the insolvency resolution process, as that would be rife with conflicts of interest.[18]

In fact, the AA at several instances, stepped up one level further, by disallowing those parties to be part of CoC, who tried to enter the process by assigning their debt to an unrelated party just before the initiation of insolvency proceedings. In the matter of *Fortune Pharma Pvt. Ltd.*,[19] the Hon'ble NCLT Mumbai Bench held, '*a related party cannot suddenly become a non-related party just because he washes off his hands and hands over the papers to other party who have no valid reason for taking up assignment of a Debt which may not be recoverable*'.

So, the scheme of the Code suggests that the responsibility of decision making on behalf of the CD has been entrusted to a body which has a capacity to do so (by avoiding OCs) and does not have undue conflict of interest (by avoiding related parties). These attributes appear to chase the requirements of CoC's competence and integrity.

CODE OF CONDUCT FOR COC

The creditor-in-control regime under the IBC has entrusted the CoC with a challenging task of giving a new life to the distressed CD. However, the AA on several occasions, highlighted deficiencies in the decision-making process of the CoC. The AA has observed instances where representatives of creditors participated in meetings without the necessary authorization to make decisions, marking undue delays even in routine matters. This raises concerns not only about the competence of the representatives but also about the effectiveness of the CoC from the perspective of financial institutions.[20] In the matter of *SBJ Exports & Mfg. Pvt. Ltd. v. BCC Fuba India Ltd.*,[21] the AA called such creditors, '*speed breakers and roadblocks obviously cause obstacles to achieve the targets of speedy disposal of the CIR process*'.

Further, in the matter of *STCI Finance Ltd. through Subash Chandra Modi v. Parinee Developers Pvt. Ltd.*, while dismissing the application of RP for withdrawal of CIRP, the AA observed that by exercising their commercial wisdom, the CoC cannot be permitted to not comply with the provisions of the IBC as well as regulations framed thereunder.[22]

Presently, the conduct and decision making of the CoC is not subject to any regulations, instructions, guidelines etc. Many stakeholders have expressed the need of a Code of Conduct for the CoC. The 32nd Report of the Parliamentary Standing Committee on finance had also recommended the same stating that, *'there is an urgent need to have a professional code of conduct for the CoC, which will define and circumscribe their decisions, as these have larger implications for the efficacy of the Code'*.[23]

In view of the vital role of the CoC and duties entrusted upon it, the IBBI came out with a discussion paper in August, 2021 wherein a Code of Conduct was proposed to be brought in for the members of CoC, that shall elevate accountability and responsibility of CoC.[24] It has been argued that as the primary decision-making body for the resolution process, the CoC acts as the custodian of public trust, ensuring that the interests of all stakeholders, including creditors, shareholders, and employees, are protected and preserved. In performing its role, the CoC must balance the competing interests of various stakeholders and act in the best interests of the public at large. The proposed Code of Conduct draws from the ethical norms on which a CoC is expected to function and act as the guiding light for the CoC while conducting itself. It aims to promote transparent working of the CoC and make participating members accountable for their actions during the process.[25]

The draft Code of Conduct proposed in the discussion paper as mentioned above, among other duties, obligates the members of the CoC to become fully aware of the provisions of the Code or rules and regulations thereunder, nominate its representative with sufficient authorisation to participate in the CoC meetings, extend the interim finance to the extent required for completion of the process etc.[26]

IS PARTICIPATION IN THE COC A RIGHT OR OBLIGATION?

Under the Code, the CoC is established as the supreme decision-making body in insolvency proceedings. It comprises all FCs who hold claims against the CD. As there is no assessment for willingness for participation in the CoC, coupled with the fact that the votes of those who do not participate in the voting are not excluded, it can be considered an obligation for eligible FCs to participate in the CoC meetings.

The success of the IBC heavily relies on the active involvement of creditors, particularly in the CoC, to make informed decisions and drive the resolution process forward. This viewpoint is supported by the Asian Development Bank Good Practice Standards on the 'Position and Role of Creditors,' which emphasizes the importance of organized, available, and involved creditors in the rescue process.[27] The current design of the IBC does not seem to adequately address the widely recognized problem of creditor apathy. In his paper on 'Creditor participation in insolvency proceedings', Prof. Roman Tomasic noted that creditors are not always enthusiastic about participating in insolvency proceedings due to the costs involved, or due to the low returns that are anticipated.[28] The recent cases of *Shri Guru Containers v. Jitendra Palande*[29] and *V. Duraisamy v. Jeyapriya Fruits and Vegetables Commission Agent*,[30] show elements of creditor apathy, wherein no claims were received by the IRP after public announcement, and hence CoC could not be constituted.

It is generally seen that obligations arise when individuals voluntarily opt for something, such as entering into a contract or assuming a specific role or responsibility. When a person makes a voluntary choice or agreement, he/she typically accepts certain obligations or duties that come with that choice. For instance, when a lease agreement is signed for an apartment, the lessee voluntarily opt for the rental arrangement and accept the obligation to pay rent on time and adhere to other terms specified in the contract. In fact, consent is a fundamental principle underlying the Indian Contract Act, 1872. According to the said Act, for a contract to be valid, it must be entered into with the free consent of all parties involved.

According to John Rawls[31] -

> ..A person is under an obligation to do his part as specified by the rules of an institution whenever he has voluntarily accepted the benefits of the scheme or has taken advantage of the opportunities it offers to advance his interests, provided that this institution is just or fair, that is, satisfies the two principles of justice.

Rights and duties are two distinct concepts that do not necessarily come hand in hand. A right is a claim or entitlement to something that is owed to an individual or group, while a duty is an obligation to act or behave in a certain way. While some rights may bring with it the corresponding obligations, the same may not hold true where the rights are owned irrespective of something done or not done. For instance, the equity shareholders of a company are entitled to receive dividend whenever the same is declared by the company, even if the shareholders do not vote or participate in the annual general meeting or shareholders' meeting. Shareholders have a right to receive dividend based on their ownership of shares, regardless of whether they exercise their voting rights.

While shareholders possess the right to participate in annual general meetings and potentially assume management positions if they hold a significant equity stake, it is not mandatory for them to exercise these privileges. Shareholders have the freedom to enjoy the financial benefits associated with their ownership, such as dividends and right issues, without any accompanying obligations. However, if a shareholder chooses to take on a management position, they are entrusted with decision-making authority that impacts other stakeholders. In such a role, the shareholder is bound by a Code of Conduct that includes penal provisions for any failures or violations.

This raises a crucial question when seen through the lens of IBC: If the related parties are not entrusted with decision making, will the uninterested participants be any better in decision making. It resembles a scenario where a majority shareholder, even if unwilling, is compelled to assume a management position and adhere to the prescribed Code of Conduct for company directors.

The obligations or regulations on a person should be proportional to the externalities that may be caused by the conduct of such person. This means that while determining obligations, it is essential to consider the potential consequences that can arise from an individual's behaviour. As an example, the requirements imposed on bus passengers should differ from those placed upon the driver. Trying to subject both parties to the same level of regulation would result in no effective regulation on either. The matter at hand prompts us to ponder: should all FCs be bound by the same obligations, regardless of their willingness to take decisive position? From the standpoint of creditors, some may not be willing to participate in the CoC meetings, and hence imposing a Code of Conduct upon them may seem excessive to many eyes.

The Code allows the initiation of CIRP even on an application by a single creditor provided the requirement of threshold default amount is met. This action by a single creditor binds all other creditors to file claims and participate in the insolvency proceedings. Let's say the applicant creditor-A holds 10% voting share in the CoC, another creditor-B holds 60% share, and there are six other creditors-C1 to C6, who hold 5% each. Suppose C5 creditor has a total exposure of Rs.100 crore in his books to the non-performing assets (NPAs) category, and his claim in the present example (Case-1) is only 0.5% of his total NPA portfolio of Rs.100 crore. C5 also has insolvency proceedings going on in another case (Case-2) wherein the claim is 20% of his total NPA exposure. Now a rational creditor would weigh the costs and benefits associated with efforts in resolving a particular case and had it been the situation where only one case can be looked after closely, C5 would choose case-2.

The CoC consists of diverse creditors with varying interests and hence expecting unwilling creditors to participate with the same level of professionalism and prioritize the best outcome for all stakeholders would not be realistic. On the contrary, allowing creditors the voluntary choice to participate in the CoC can expedite decision-making and improve the efficiency of the resolution process under the Code. This voluntary participation also facilitates the effective enforcement of the Code of Conduct among CoC members.

The BLRC also anticipated such scenario where some creditors may choose not to participate in the CoC meetings, and accordingly suggested that vote of the CoC should be counted without taking into account the vote of the absent creditors.[32] However, the Code made it mandatory for FCs to participate in the CoC, thus creating an obligation on FCs. Under the present provisions, the proposed Code of Conduct, if implemented, will be an added obligation on the FCs. It is crucial to acknowledge that all creditors possess an inherent right to recover their dues, irrespective of their involvement in the CoC. This means that participating in the CoC may be less appealing for creditors unless they are willing to make business decisions for the CD. Therefore, becoming a CoC member should be a voluntary decision rather than a mandatory obligation.

INTERNATIONAL PRACTICE

On the subject of creditor participation, the UNCITRAL Legislative Guide on Insolvency Law, argues that the insolvency law should specify the creditors who are entitled to participate in the insolvency proceedings and identify what functions shall be involved as a result of such participation. While providing guidance on constitution of creditors' committee, it states that a possible approach for an insolvency law may be not only to specify those creditors which can be represented in a given case, but to allow creditors to collectively choose their own representatives *on the basis of willingness to serve* (to address the common problem of creditor apathy) and to provide for enlargement or reduction of the size of the committee as required.[33]

Further, section 1102 of the Chapter 11 of the US Bankruptcy Code, deals with constitution of creditors' committee and provides that it shall ordinarily consist of the persons, *willing to serve*, that hold the seven largest claims against the debtor of the kinds represented on such committee. This committee is responsible for consultations with the trustee or the debtor regarding administration of the case; investigation of assets, liabilities and financial position of the debtor; formulation of reorganization plan; appointment of various professionals, etc.

The Insolvency (England and Wales) Rules, 2016 provides for the formation of creditors' committee to assist the office-holder in discharging of its functions in administration proceedings of the distressed debtor. Chapter 3 of the Rules, provide that a committee in an administration, administrative receivership or a bankruptcy must have at least three members but not more than five members. Rule 17.5 of the said Rules indicates that before a person acts as a member of the committee, that person *must agree to do so*.

Therefore, it seems to be a widely acknowledged practice on an international scale to choose members for a creditors' committee based on their voluntary willingness to serve. This criterion ensures that creditors who are genuinely interested and enthusiastic about participating in the committee are chosen.

RECOMMENDATIONS AND WAY FORWARD

The Code aims at reorganisation of the distressed corporate in a time bound manner. There is no doubt in saying that in any decision-making process, if key stakeholders or decision-makers are unwilling to participate or provide inputs, it can lead to delays, and sub-optimal decisions. The creditors, especially smaller ones, may have limited resources in terms of time, personnel, and financial capacity to actively participate in the CoC. This can hinder their ability to dedicate significant resources to attend meetings, review documents, and engage in detailed discussions. Mandatory participation may put additional burden on such creditors, potentially impacting their active involvement.

The Code being a modern economic law should respect the choices of stakeholders unless these obstruct other people's rights. Allowing creditors the voluntary choice to participate in the CoC can expedite decision-making, resulting in faster resolutions and increased recovery rates. Moreover, when the Code of Conduct is applied to creditors who have willingly chosen to become members of the CoC, its enforcement becomes more streamlined and effective.

To facilitate the voluntary participation of creditors in the CoC, one possible method could be to incorporate a section in the claim forms, as outlined in Schedule-I of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, where creditors can indicate their willingness or otherwise for becoming a CoC member. In addition, this section can also state that wherever a creditor chooses this option in affirmative, the Code of Conduct for members of CoC will be applicable to the creditor. This voluntary adoption would make such creditors accountable for their decisions as per the Code of Conduct.

As it would be for any change, some undesirable situations may arise in certain cases, like it may lead to a scenario where no creditor voluntarily opts to become a CoC member. However, it is preferable to have decisions made by capable and interested individuals, and any potential issues can be addressed through appropriate design modifications. Furthermore, it needs to be considered that implementing a Code of Conduct while keeping participation in CoC mandatory would likely contribute to increased creditor apathy.

In all, it is worth considering to respect the individual choices of stakeholders and separate the obligation to participate in a CoC from the rights to receive due proceeds. If such a scheme is adopted, the Code of Conduct for such voluntary participants will be a logical subsequent step. This Code of Conduct would outline the expected standards of behaviour and ethical conduct for those who voluntarily choose to be part of the CoC.

[1] Report of the Bankruptcy Law Reforms Committee, November, 2015.
[2] *Ibid.*
[3] *Ibid.*
[4] Section 21, IBC.
[5] Supra Note 1.
[6] IBBI Discussion Paper dated 27th August, 2021.
[7] Supra Note 4.
[8] Section 22, IBC.
[9] Section 28, IBC.
[10] Section 30, IBC.
[11] Section 33, IBC.

[12] Civil Appeal No. 10673 of 2018, C.A. No.10719 of 2018,10971 of 2018 and SLP (C) No.29181 of 2018.

[13] Civil Appeal No. 8766-67 of 2019, Diary No.24417 of 2019.

[14] Jackson T. H. (1982), "Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain", 91 Yale Law Journal, pp. 859-871.

[15] Adler B. E. (2018), "The Creditor's Bargain Revisited", University of Pennsylvania Law Review, Vol. 166, No.7, pp. 1853-1865.

[16] Supra Note 4.

[17] IBBI and Vidhi Centre for Legal Policy, "Understanding the Insolvency and Bankruptcy Code, 2016: Analysing developments in jurisprudence".

[18] Saraf R. (2018), "The Concept of Related Party: Interpretation by Letter or Spirit of IBC", Vinod Kothari Consultants, 20th November, 2018.

[19] MA 560 in CP No. 1148-I&BC-NCLT-MB-MAH-2017, 13th November, 2017.

[20] Shukla S. and Jayaram K. (2021), "Promoting common good amidst anti-common behaviour of stakeholders: Role of Committee of Creditors", Quinquennial of Insolvency and Bankruptcy Code, 2016, IBBI's Annual Publication, October, 2021.

[21] C.P. 659/2016, 7th June, 2018.

[22] IA No.264 of 2021 in C.P.(IB) 4147/MB/2019, 31st May, 2021.

[23] The Ministry of Corporate Affairs, 32nd Report of Standing Committee on Finance, Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions, August, 2021.

[24] Supra Note 6.

[25] *Ibid.*

[26] *Ibid.*

[27] Law and Policy Reform at the Asian Development Bank, Vol. 1, April, 2000, p.42.

[28] Tomasic R. (2006), "Creditor Participation in Insolvency Proceedings - Towards the Adoption of International Standards", Insolvency Law Journal, Vol. 14, pp. 173-187. The paper was presented at the Forum for Asian Insolvency Reform (FAIR) organised by the OECD and the Development Research Centre of the State Council of the PRC, held in Beijing, 27-28 April, 2006.

[29] Company Appeal (AT) (Insolvency) No.106 of 2023.

[30] Company Appeal (AT) (CH) (Ins) No.25-2022.

[31] Rawls J. (1999), "A Theory of Justice", Revised Edition, The Belknap Press of Harvard University Press, Cambridge, Massachusetts, p.301.

[32] Supra Note 1.

[33] UNCITRAL Legislative Guide on Insolvency Law, 2005, pp.197-198.

04

Liability of Legal Heirs in Personal Insolvency

- Prachi Apte and Sushanta Kumar Das

BACKGROUND

Repayment of debt held immense significance in the ancient Hindu legal system, literature, and society. It holds great importance, particularly at the time of one's death. According to Hindu mythology, if a person passes away without settling their debts, they are believed to be reborn as a servant or slave in the home of their creditor. Hindu scholars and sages emphasize that if a Hindu dies without repaying their debt, it becomes the duty of their son to fulfill the obligation and absolve their father from the burden of debt. This belief gave rise to the concept of 'pious obligation'.

The term 'pious' refers to religious or moral duties, while 'obligation' signifies responsibility. The doctrine of pious obligation establishes a specific liability on the son to repay his father's debt. In general, the son, grandson, and great-grandson are accountable for repaying the debts of their respective predecessors. Thus, the primary purpose of this doctrine is to release the father from the sin of non-payment of debt.[1] The underlying rationale for this obligation is that when a son inherits certain rights, properties, and benefits, it is reasonable for him to assume the liability for the repayment of debt. However, this doctrine underwent a significant change with the amendment of the Hindu Succession Act in 2005.[2] This amendment explicitly abolished the doctrine of pious obligation of sons to repay their fathers' debts. It is essential to note that this legal change has a prospective application. However, cases arising prior to the amendment's implementation will still continue to be governed by the traditional principles of the doctrine. In essence, while the concept of pious obligation has been removed from the legal framework, its historical implications still hold weight in certain contexts.

This doctrine can serve as a useful analogy to highlight the concept of familial responsibility for debt repayment by the legal representative under the Insolvency and Bankruptcy regime in India. More particularly under the insolvency resolution process of individual debtor, if the debtor dies during the insolvency resolution process, will the process continue against legal representative of the debtor or abates? While the doctrine of pious obligation specifically applies to the son, in modern times the application of the doctrine of pious obligation would vary depending on the specific legal jurisdiction and applicable laws. This ensures that the interests of all stakeholders, including creditors and the estate of the deceased individual, are properly considered and accounted for during the resolution process.

PERSONAL GUARANTOR IN IBC

In 2018, the Parliament brought about a significant amendment to the Insolvency and Bankruptcy Code, 2016 (IBC/Code) with the intention of encompassing provisions specific to 'personal guarantors' within the realm of the Code. This amendment entailed the replacement of the prior definition in section 2(e) with the introduction of three distinct categories of debtor: 'personal guarantors to corporate debtors [Section 2(e)]', 'partnership firms and proprietorship firms [Section 2(f)]', and 'other individuals [Section 2(g)]'.

Section 5(22) of the Code defines the term 'personal guarantor' as an individual who stands as a surety in a contract of guarantee to a corporate debtor (CD). This definition finds reinforcement in the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtor) Rules, 2019 (IRP Rules). Clause (e) of Rule 3 of the IRP Rules elaborates a 'guarantor' as a debtor who assumes the role of a personal guarantor to a CD and whose guarantee has been invoked by the creditor yet remains either partially or entirely unpaid.

The above definitions underscore the pivotal significance of incorporating personal guarantors within the Code's ambit. This inclusion effectively acknowledges their critical role in underwriting financial transactions involving CD. It ensures that creditors possess the means to reclaim their outstanding dues not just from the CD but also from the individual acting as the personal guarantor, in case of default.

Generally, personal guarantors consist of directors, promoters, or significant stakeholders, and they are closely linked to the CD. They pledge their personal assets and creditworthiness as collateral to bolster the financial standing of the CD, thereby facilitating enhanced access to financing resources.

By extending due recognition to the role of personal guarantors under the Code, the legislative framework takes decisive steps in addressing scenarios of insolvency and default involving these individuals. This framework lays out clear guidelines for the initiation of insolvency proceedings against personal guarantors, thereby ensuring an equitable and transparent resolution process for all stakeholders engaged in the proceedings.

Ultimately, the definition of a guarantor as articulated in clause (e) of Rule 3 of the IRP Rules not only provides lucidity concerning the status and responsibilities associated with individuals assuming the role of personal guarantors to CDs, but it also reinforces accountability for unsettled guarantees. This reiteration of financial probity and debt repayment aligns seamlessly within the broader contours of the insolvency and bankruptcy framework.

LIABILITY OF PERSONAL GUARANTOR AND PROCESSES UNDER THE IBC

A creditor invoking the guarantee, signifies the creditor's exercise of their entitlement to seek payment from the guarantor, stemming from the default of the CD. In such instances, the guarantor assumes liability towards the creditor for the unsettled amount, be it the entirety of the debt or an outstanding partial sum. This places an obligatory duty upon the guarantor to uphold the guarantee and fulfil the outstanding debt owed to the creditor on behalf of the CD.

It is imperative to delve into the procedural framework[3] outlined in Part III of the Code, with a specific focus on the provisions pertaining to personal guarantors. The insolvency resolution process is a framework for the personal guarantor to collectively negotiate a repayment plan under the supervision of the Resolution Professional (RP). Both the personal guarantor and creditor can make an application for initiation of the process under section 94 or 95 of the Code respectively. If the application is admitted by the Adjudicating Authority (AA), a public notice is issued inviting claims from all creditors. The personal guarantor then prepares a repayment plan, in consultation with the RP. If the plan is approved by 75% of the voting share of the creditors, and thereafter by the AA, the RP supervises its implementation. On execution of the repayment plan, the AA issues a discharge order releasing the personal guarantor from its liability in terms of the plan, and the debtor gets 'earned start'.

In the event of failure of the resolution process or repayment plan is not implemented, the personal guarantor or creditor may make an application for the initiation of bankruptcy process. If the application is admitted, the AA passes a bankruptcy order and appoints a Bankruptcy Trustee (BT), followed by an invitation of claims from creditors. The BT investigates the affairs of the bankrupt, realises the estate of the bankrupt and distributes the proceeds in accordance with the priority provided in the Code. He submits a report of administration of estate of the bankrupt to the committee of creditors (CoC) for approval. On expiry of one year from the bankruptcy commencement date or within seven days of the approval by the CoC, the BT applies for a discharge order and the AA passes a discharge order. The discharge order releases the personal guarantor from the bankruptcy debt. The bankrupt, however, suffers certain disabilities during the period of bankruptcy process.

Here, it is pertinent to refer sub-section (5) of section 123 of the Code, which provides for initiation of bankruptcy proceedings against the legal representatives of the deceased debtor. Section 169 and 170 of the Code also allow the continuation of bankruptcy proceedings of a deceased debtor. Therefore, the Code allows the initiation as well as continuation of bankruptcy proceedings of a deceased debtor, but creditors are not allowed to continue the insolvency resolution process of the deceased debtor.

The absence of provisions allowing for continuation of insolvency proceedings against the legal representatives in the event of the death of the debtor assumes significance as it leads to an abrupt and premature halt to the ongoing insolvency process, leaving crucial matters unresolved and with no recourse.

This differential treatment in the insolvency resolution process and bankruptcy stages underscores a salient and consequential disparity. The absence of a provision analogous to section 123(5) during the insolvency resolution stage curtails the rights and responsibilities of the debtor's legal representative, resulting in an unintended void in the insolvency process. This not only curbs the potential for a more holistic resolution but also imposes limitations on the rightful involvement of all relevant stakeholders, especially in cases where the debtor's demise occurs during the course of the insolvency proceedings.

LIABILITY OF THE LEGAL REPRESENTATIVE IN CASE OF DEATH OF THE PERSONAL GUARANTOR

As per the data published by the Insolvency and Bankruptcy Board of India (IBBI), at the end of June 2023,[4] 2039 applications have been filed to initiate the insolvency resolution process of personal guarantors at various benches of National Company Law Tribunal (NCLT) and Debt Recovery Tribunal. Out of them, 127 cases have been closed as dismissed or withdrawn either before or subsequent to the appointment of RP. Upon a thorough analysis, it is seen that within this pool of 127 cases, a significant subset of 16 cases have been closed due to the death of the personal guarantor.

Some of the notable cases are discussed below.

In the matter of *Bank of Baroda v. Ms. Divya Jalan*[5]

In this matter, Bank of Baroda filed an application under section 95 for initiation of insolvency proceedings against the legal representatives of the deceased personal guarantor namely Ms. Divya Jalan. The AA held that the application could not be maintained or accepted against the legal representatives of the guarantor under the Code, and the remedies may lie elsewhere. The lender can take appropriate steps to recover the guaranteed amount from the assets/estates of the deceased guarantor rather than the personal assets of the legal representatives. Hence, in the absence of the enabling provision, the legal representatives lost an option to participate in the insolvency proceedings to save the assets of the deceased guarantor from the bankruptcy proceedings.

In the matter of *Alchemist Asset Reconstruction Company v. Mr. Deepak Puri*[6]

Yet in another instance, Alchemist Asset Reconstruction Company initiated the insolvency resolution process against Mr. Deepak Puri, personal guarantor of M/s Moser Baer India Limited. As per section 99 of the Code, the RP submitted a report to the AA. In his report he submitted that Mr. Puri passed away during the process and he recommended for rejection of the application in the absence of any provision to admit or continue the process. Accordingly, the AA rejected the application. The grounds for this dismissal were rooted in the belief that proceedings against the personal guarantor would naturally cease upon his/her demise, effectively negating any need for continuation of proceedings against a deceased individual.

These peculiar scenarios came to the forefront, shedding light on nuanced situations. In the case of *Divya Jalan supra,* the personal guarantor had passed away before the initiation of the process, and in the case of Mr. *Deepak Puri supra,* the personal guarantor passed away during the process. Such scenarios prompt a deeper analysis into the adequacy of existing provisions within the Code to comprehensively address these intricate nuances. It raises questions about whether the current legal framework truly encompasses the complexities arising from such situations, thereby necessitating a potential re-examination or refinement of the law to ensure equitable and robust insolvency practices.

In the absence of specific provisions or clarifications regarding the continuation of insolvency process against the legal representatives of debtor, it becomes imperative to consider other relevant laws and legal advances in India and international jurisdictions. These sources serve as valuable references to ascertain whether the insolvency process can be pursued against the legal representatives of the debtor and to determine the extent of their liability in such scenarios.

REPORT OF THE BLRC

The aspect of continuation of the insolvency resolution process in the event of death of the debtor has been duly discussed by the Bankruptcy Law Reforms Committee (BLRC). As per the Report of the BLRC, in the event of the death of the debtor during the insolvency resolution process, the process may be continued by the legal representatives. The Committee discussed various aspects related to this scenario.

Firstly, the Committee opined that, during the negotiation process, which should be concluded within a six-month moratorium period, if the debtor passes away, the legal representative may assume responsibility for the ongoing negotiations. It is crucial to reach a consensus during this time. If an agreement is reached, the AA should approve it without modifications to give effect to the agreement. However, failure to reach a consensus or the refusal of the next-of-kin to participate in the negotiation process leads to the failure of the insolvency resolution process.[7]

Secondly, in terms of implementing the repayment plan, if the debtor becomes disabled during the plan's implementation, the debtor and creditors can renegotiate a new plan to accommodate the changes in circumstances. However, if the debtor dies during this phase, the legal representatives have two options. They can either choose to continue with the repayment plan, ensuring the debtor's assets are used to fulfil the outstanding debts, or request an Adjudicator-led bankruptcy process. In the bankruptcy process, the deceased debtor's assets will be sold to repay the creditors, up to the value of the debt owed at that time. This ensures that the next-of-kin bears the cost, either through regular cash flow payments or through the sale of the debtor's assets, potentially impacting their inheritance.[8]

The Report emphasizes the importance of addressing the involvement of legal representatives in the insolvency process when a debtor passes away. These provisions aim to ensure that the process remains fair and that there are mechanisms in place to address the rights and responsibilities of the legal representative in continuing the repayment plan or pursuing the bankruptcy process.

The intention of the legislature behind not including the recommendations of the BLRC in the Code remains unclear. It is uncertain whether this omission was a deliberate decision or an oversight. However, this gap has given rise to a challenging situation in practice in the present day. This gap became evident in the cases of *Deepak Puri supra* and *Divya Jalan supra*, wherein the AA noted that the Code does not encompass the concept of legal representatives stepping into the shoes of a deceased guarantors. Currently, due to the absence of provisions for the continuation of proceedings involving legal representatives, the insolvency process is abruptly terminated. In other words, there is no provision for the closure of the process in the event of the death of the debtor. Despite the observations made by the BLRC, these views have not been incorporated into the Code. Therefore, the authors emphasize the significance of incorporating the recommendations of the BLRC into the Code through a judicious amendment process. This potential revision would not only bridge the existing gap but also contribute to the Code's overarching objective of providing a comprehensive and just framework for insolvency proceedings.

OTHER INDIAN LAWS ADDRESSING DECEASED PARTY SCENARIO

The Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920

It is pertinent to mention here that the Presidency Towns Insolvency Act, 1909 (Presidency Towns Act), and the Provincial Insolvency Act, 1920 (Provincial Insolvency Act) are two significant pieces of legislation in India that deal with insolvency and bankruptcy matters. They were enacted during the British colonial period and continue to be relevant today. With the introduction of the Code in 2016, many provisions of these Acts have been subsumed under the Code. However, they still retain relevance in specific contexts and jurisdictions, providing historical insights into the evolution of insolvency laws in India.

The Presidency Towns Act applies to the three presidency towns of India at that time - Calcutta (now Kolkata), Bombay (now Mumbai), and Madras (now Chennai). The Act governs the insolvency proceedings of individuals residing in these towns, while, the Provincial Insolvency Act is applicable to the rest of British India, excluding the presidency towns. It governs insolvency proceedings for individuals and unincorporated entities outside the presidency towns.

Section 93 of the Presidency Towns Act provides for the continuation of proceedings upon the death of a debtor. According to this section, if a debtor against whom an insolvency petition has been filed passes away, the proceedings will generally continue as if the debtor were still alive, unless the court orders otherwise.

This provision demonstrates a clear recognition of the importance of continuing insolvency proceedings even after the debtor's death. It underscores the need to ensure that the process remains intact and that the rights and interests of all parties involved, including legal heirs, are adequately addressed.

Similarly, section 17 of the Provincial Insolvency Act deals with the continuation of proceedings upon the death of a debtor. It provides that if a debtor against whom an insolvency petition has been filed passes away, the court may decide to continue the proceedings as necessary for the realization and distribution of the debtor's assets, unless an alternative order is given. This provision not only acknowledges the insolvency of individuals but also emphasizes the importance of continuing the proceedings to ensure proper handling of the debtor's estate.

Perusal of above provisions makes it evident that the concept of continuing proceedings against legal heirs is recognized and implemented in these legal frameworks.

The Civil Procedure Code, 1908

The Civil Procedure Code of 1908 (CPC) also contains provisions regarding the death of parties involved in a lawsuit. Order XXII[9] specifically addresses the abatement of a suit due to the death, marriage, or insolvency of a party.

According to Rule 1,[10] if the right to sue survives despite the death of a plaintiff or defendant, the suit will not abate solely on account of the party's death.

Rule 3[11] outlines the procedure to be followed when one of several plaintiffs or the sole plaintiff passes away. In such cases, the court, upon application, will include the legal representative of the deceased plaintiff as a party and proceed with the suit. However, if no application is made within the specified time, the suit may abate as far as the deceased plaintiff is concerned, and the court may award costs to the defendant, recoverable from the estate of the deceased plaintiff.

Further, Rule 4A[12] deals with situations where there is no legal representative of the deceased party. The court may proceed in the absence of a representative or appoint an Administrator-General, court officer, or any other suitable person to represent the estate for the purpose of the suit. Any judgment or order subsequently made in the suit will bind the estate of the deceased person to the same extent as if a personal representative had been involved.

Rule 6[13] ensures that even if a party dies after the conclusion of the hearing but before the pronouncement of judgment, the suit will not abate. The court can still pronounce the judgment, which will have the same legal effect as if it had been pronounced before the party's death.

These provisions from the CPC demonstrate that the legal system acknowledges the importance of addressing the death of a party during legal proceedings and provides mechanisms to ensure continuity of the suit. Such provisions support the argument for including similar provisions in the Code to address the involvement of legal heirs in insolvency processes.

The Indian Contract Act, 1872

The provisions related to joint liabilities and rights, as well as the revocation of a continuing guarantee upon the death of the surety are provided in the Indian Contract Act, 1882 (ICA). Section 42[14] of the ICA provides that when two or more persons have jointly made a promise, unless the contract indicates otherwise, all the individuals are responsible for fulfilling the promise during their joint lives. After the death of any of them, their representative becomes jointly liable with the surviving parties. Finally, after the death of the last survivor, the representatives of all the parties are collectively responsible for fulfilling the promise.

Similarly, section 45[15] addresses the devolution of joint rights. When a person has made a promise to two or more individuals jointly, the right to claim performance rests with all of them during their joint lives. After the death of any of them, the representative of the deceased person becomes jointly entitled to the right with the survivor or survivors. Lastly, after the death of the last survivor, the representatives of all the parties jointly hold the right.

Regarding continuing guarantees, section 131[16] states that, in the absence of any contrary contract, the death of the surety acts as a revocation of a continuing guarantee for future transactions.

These provisions within the ICA emphasize the principles of joint liability, joint rights, and the impact of a surety's death on a continuing guarantee. By considering these provisions, it becomes apparent that the legal framework recognizes the role of legal heirs in fulfilling joint promises and rights.

The Indian Succession Act, 1925

The Indian Succession Act, 1925 also includes provisions related to the lapsing of bequests upon the death of a legatee in the testator's lifetime.

According to section 109,[17] if a bequest has been made to a child or other lineal descendant of the testator, and the legatee dies during the testator's lifetime, but any lineal descendant of the legatee survives the testator, the bequest does not lapse. Instead, it takes effect as if the legatee had died immediately after the testator, unless the Will indicates a contrary intention.

Similarly, section 110[18] addresses situations where a bequest is made to one person for the benefit of another. In such cases, if the person to whom the bequest is made dies during the testator's lifetime, the legacy does not lapse.

These provisions in the Indian Succession Act, 1925 ensure that bequests made to children, lineal descendants, or for the benefit of others are preserved even if the intended legatee dies before the testator. They prevent the bequests from lapsing and allow them to take effect as if the legatee had died immediately after the testator's death, unless the Will indicates otherwise.

Considering these provisions, it is evident that the Indian Succession Act, 1925 recognizes the preservation of bequests and the continuation of rights in cases where the intended legatee dies during the testator's lifetime.

CROSS-COUNTRY COMPARISON

Exploring the practices prevalent in foreign jurisdictions is crucial to understand how different countries address the issue of a debtor's death during the insolvency process and how their respective laws handle such situations. The related provisions of some of the countries are discussed in the following para.

United Kingdom

Section 81[19] of the Insolvency Act of 1986 deals with contributories in the event of a member's death. If a contributory (a person liable to contribute to a company's assets in the event of its winding up) dies, whether before or after being listed as a contributory, his personal representatives (those responsible for administering his estate) and the heirs and legatees of heritage of his heritable estate in Scotland are held liable to contribute to the company's assets in accordance with the proper administration of his estate. Therefore, they become contributories and bear the responsibility for fulfilling the deceased contributory's liabilities.

In cases where the personal representatives are listed as contributories, it is not necessary to include the heirs or legatees of heritage. However, they may be added to the list at the court's discretion.

In England and Wales, if the personal representatives fail to make the required payments as ordered, legal proceedings can be initiated to administer the deceased contributory's estate and compel the payment of the outstanding amounts from the estate.

This provision in the United Kingdom's Insolvency Act recognizes the liability of personal representatives, heirs, and legatees of heritage in relation to the debts and obligations of a deceased contributory. It establishes their responsibility to contribute to the company's assets and ensures that the company's financial obligations are properly addressed.

United States of America

In the United States, the practice regarding the continuation of the insolvency process against the legal heirs in the event of the debtor's death is governed by Title 11 of the US Bankruptcy Code, and the Federal Rules of Bankruptcy Procedure.

According to Rule 1016[20] of the Federal Rules of Bankruptcy Procedure, the death or incompetency of the debtor does not abate a liquidation case under Chapter 7 of the Bankruptcy Code. In such cases, the estate is administered, and the case is concluded in the same manner as if the death or incompetency had not occurred. This means that the proceedings continue, and the assets of the debtor are liquidated to satisfy the claims of creditors.

However, if the case of reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under Chapter 11, Chapter 12, or Chapter 13 respectively, the situation may be different. The rule states that the case may be dismissed if the debtor's death or incompetency prevents their active participation, as is often the case in Chapter 11 and Chapter 13 bankruptcy. Alternatively, if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in a manner as if the death or incompetency had not occurred.

Chapter 13 Bankruptcy involves a repayment plan spanning three to five years, the debtor's active participation is crucial. If the debtor fails to make the required monthly payments to the bankruptcy trustee, the court may dismiss the case without granting a discharge. Dismissal is generally favoured in Chapter 13 cases because the success of the bankruptcy relies on the debtor's ability to fulfil their payment obligations.

It is important to note that the specific treatment of the debtor's death in bankruptcy proceedings can vary depending on the chapter under which the case is filed and the circumstances surrounding the case. The rules and procedures outlined in the US Bankruptcy Code and the Federal Rules of Bankruptcy Procedure aim to strike a balance between the interests of creditors and the practical considerations of administering the estate when the debtor is no longer able to participate actively.

CONCLUSION AND WAY FORWARD

In this intricate web of legal mechanisms, the harmony between the Code's provisions, the operational guidelines set by the IRP Rules, and the practical application of insolvency proceedings against individual debtors is of paramount importance. As the realm of insolvency and bankruptcy undergoes constant transformation, these provisions reflect a well-orchestrated strategy to guarantee not only the protection of creditors' rights but also the stability of financial systems. As the landscape of insolvency and bankruptcy continues to evolve, these measures stand as a testament to the legislative foresight aimed at ensuring a robust and equitable resolution process, while fostering a climate conducive to economic growth and creditor confidence.

The absence of a provision enabling the seamless substitution of legal representatives during the insolvency resolution process has inevitably led to a consequential practice of filing of bankruptcy applications against the legal representatives of the debtor, even as a potential resolution opportunity is at hand. This practice, undoubtedly, casts an unfortunate stigma upon the bankrupt individual and further complicates an already challenging situation.

In light of this, it becomes imperative to underscore the need for reform. The authors strongly advocate for a revised approach that empowers the legal representatives of the debtor to actively participate in the insolvency resolution process. The current absence of such a provision during the insolvency resolution stage hastens the process towards the initiation of bankruptcy. This, in turn, denies an opportunity for legal representatives to rightfully inherit parental or ancestral property, exacerbating the complex aftermath of insolvency.

This unintended consequence not only adds an unjust stigma to the legal representatives but also perpetuates the societal perception of bankruptcy as a stigma. In the Indian context, insolvency continues to carry negative connotations, and this further highlights the need for a more nuanced legal provision. The viewpoints of the BLRC, along with other prevailing domestic and international laws, accentuate the need to acknowledge and address this disparity by enabling legal representatives to participate in the insolvency proceedings.

The present scenario strongly suggests the necessity for a more holistic examination of the existing legal framework. It is vital to ensure that the law not only operates efficiently but also provides equitable remedies for all stakeholders involved. A comprehensive analysis is imperative to uphold the principles of fairness, transparency, and inclusivity, ultimately fostering an insolvency regime that respects the rights and dignity of all parties concerned.

[1] Agnihotri S. (2022), "A Critical Analysis of Doctrine of Pious Obligation", March 10.

[2] Section 6 of Hindu Succession Act, 1956:

> Devolution of interest in coparcenary property- (4) After the commencement of the Hindu Succession (Amendment) Act, 2005 (39 of 2005), no court shall recognise any right to proceed against a son, grandson or great-grandson for the recovery of any debt due from his father, grandfather or great-grandfather solely on the ground of the pious obligation under the Hindu law, of such son, grandson or great-grandson to discharge any such debt:
>
> Provided that in the case of any debt contracted before the commencement of the Hindu Succession (Amendment) Act, 2005 (39 of 2005), nothing contained in this sub-section shall affect:
>
> (a) the right of any creditor to proceed against the son, grandson or great-grandson, as the case may be; or
>
> (b) any alienation made in respect of or in satisfaction of, any such debt, and any such right or alienation shall be enforceable under the rule of pious obligation in the same manner and to the same extent as it would have been enforceable as if the Hindu Succession (Amendment) Act, 2005 (39 of 2005) had not been enacted.
>
> **Explanation.** For the purposes of clause (a), the expression son, grandson or great-grandson shall be deemed to refer to the son, grandson, or great-grandson, as the case may be, who was born or adopted prior to the commencement of the Hindu Succession (Amendment) Act, 2005.

[3] The Central Government, vide a notification dated November 15, 2019, appointed December 1, 2019 as the date for commencement of the provisions of the Code relating to personal guarantors to the CDs. It also notified the IRP Rules on the same date.

[4] Quarterly Newsletter of IBBI, April-June 2023.

[5] *Bank of Baroda v. Divya Jalan,* CP (IB) No. 363/KB/2021 [(2022) ibclaw.in 180 NCLT].

[6] *Alchemist Asset Reconstruction Company v. Mr. Deepak Puri,* IA - 376/2022 in (IB) - 438(PB)/2021 [(2022) ibclaw.in 112 NCLT].

[7] The Report of the Bankruptcy Reforms Committee Volume-1: Rationale and Design, November, 2015, pp. 119-122

[8] *Ibid.*

[9] Order XXII of Civil Procedure Code, 1908-Death, Marriage and Insolvency of Parties, Civil Procedure Code.

[10] Rule 1 of Civil Procedure Code, 1908-No abatement by party's death, if right to sue survives.

[11] Rule 3 of Civil Procedure Code, 1908- Procedure in case of death of one of several plaintiffs or of sole plaintiff.

[12] Rule 4A of Civil Procedure Code, 1908- Procedure when there is no legal representative.

[13] Rule 6 of Civil Procedure Code, 1908- No abatement by reason of death after hearing.

[14] Section 42 of India Contract Act, 1872- Devolution of joint liabilities.

[15] Section 45 of India Contract Act, 1872- Devolution of joint rights.

[16] Section 131 of India Contract Act, 1872- Revocation of continuing guarantee by surety's death.

[17] Section 109 of Indian Succession Act, 1925- When bequest to testator's child or lineal descendant does not lapse on his death in testator's lifetime.

[18] Section 110 of Indian Succession Act, 1925- Bequest to A for benefit of B does not lapse by A's death.

[19] Section 81of Insolvency Act, 1986- Contributories in case of death of a member.

[20] Rule 1016 of Federal Rules of Bankruptcy Procedure - Death or Incompetency of Debtor.

Part II
Trends and Developments

05

Attachment of Property Under PMLA and other Statutes Vis-a-Vis IBC Law

- Nainshree Goyal

INTRODUCTION AND OBJECTIVE OF IBC

The Insolvency and Bankruptcy Code, 2016 (IBC/ Code) is a very young law. The country has been experiencing changes with respect to this law at economic, legal, banking as well as commercial level. It is relevant to know the purpose of this law deeply to understand the direction behind this research. Various judgements have evolved in past seven years that emphasise on the given purpose of the law:

a) IBC is for resolving and restitution of the sick units and not for recovery of debt in a time bound manner;

b) IBC aims to preserve the value of assets involved in question by way of moratorium under section 14;

c) IBC also caters to promoting entrepreneurship, availability of credit, and balancing the interests of stakeholders.[1]

Furthermore, the Supreme Court of India identified sacrosanct objectives of IBC in *Swiss Ribbons Private Limited,*[2] saying that as resolution plan takes off, the corporate debtor (CD) is able to repay its debts, which promotes credit market. Also, as the CD benefits from the resolution, the interests of all stakeholders are looked after. The Code ensures revival and continuation of the CD by protecting it from its own management and from liquidation.

The aim is to ensure that the CD keeps operating as a going concern during the insolvency resolution process as well, and must therefore, make past and present payments to various operational creditors without which such operation as a going concern would become impossible.[3] It does not aim to close-down the organisation, obstruct the business, take out or de-value the assets or penalise the organisation in anyway.

Strategic changes and other re-organisational policies often acts as helping hand too. But the aspect to understand here is that the strategy-maker who is responsible for the downfall of the organisation, the one who could not pay the debts and ended up in the insolvency proceeding, cannot be again given the control and decision making power to bring out such an organisation from the pothole. Least interference of such persons/ promoters are entertained, and that is why a third person called as the Insolvency Professional is handed over the management of organisation. It is essentially a statute which works towards the revival of a corporate body, which is unable to pay its debts, by appointment of a Resolution Professional (RP).[4]

This whole discussion made above, points out towards successful revival of the organisation[5] and preservation of its assets and smooth running of the organisation in market as the penultimate goal, ultimately benefiting the economy as a whole.

ROLE OF MORATORIUM AND SECTION 32A UNDER THE CODE

To understand and justify the precedents towards the Code having an overriding effect over other laws, one needs to understand the role of moratorium. The object of the Code is clearly that there should be no depletion of CD's assets during the corporate insolvency resolution process (CIRP). The mandate of the Code is that the moment an insolvency application is admitted, the moratorium comes into effect under section 14(1)(a) expressly interdicts institution or continuation of pending suits or proceedings against CD.[6] The assets of the CD have to be preserved, protected and guarded for a successful insolvency resolution, which is the object of engrafting section 14 in the statute.[7] Once the proceedings under the Code has commenced and an order declaring moratorium has been passed by the Adjudicating Authority (AA), then if the assets of the CD are alienated during the pendency of the proceedings under the Code, it will seriously jeopardise the interest of all the stakeholders[8] and the end goal of resolving the organisation will fail badly. Moratorium prevents any initiation of action against the CD. So far as a suit under Civil Procedure Code is concerned, if filed before any High Court under original jurisdiction which is a money suit or suit for recovery, against the CD, such suit cannot proceed after declaration of moratorium under section 14 of the Code.[9]

Section 14 of the Code only prohibits a suit or a proceeding of a like nature and does not include any criminal proceeding.[10] But later *via* the 2020 Amendment Act,[11] section 32A was added to the Code *via* amendment. This amendment was a step further to fulfil the objective of the Code, with an aim to protect the property of the CD from any criminal proceedings as well. This is seen as an important step to revive the old units and have the organization into a running mode for better growth by the new management which takes over for resolution. Through a reading of section 14 of the Code, it can be said that section 14 is not applicable to the criminal proceeding, or any penal action taken pursuant to the criminal proceeding or any act having the essence of crime or crime proceeds.

To ensure brevity, the highlight of section 32A is that any liability of a CD for an offence committed prior to the commencement of the CIRP shall cease. This shall prevail if any provision is contrary to this Code or any other law. This section is a bundle that has proviso and exceptions, to be applied strictly keeping the objective of the Code in mind as discussed above.

It must be carefully noted, specifically for the purpose of the given research, that the protection given by the Code is solely towards the CD and its assets and not the promoter or the suspended director or such individuals. The legal actions or proceedings against such an individual are allowed to be continued normally. This further brings to the table of discussion, a vital point that criminal proceedings are always against an individual/living beings and not a corporate entity anyways. Therefore, it can be well interpreted that the prosecution proceedings under criminal proceedings may not hamper CD directly, even if any criminal complaint is filed against the director or the CD. The concept of 'lifting corporate veil' will also be immensely important in interpreting and executing section 32A of the Code.

Both the given provisions discussed here, i.e. section 32A and section 14 towards moratorium, are enacted in the Code with the aim to protect the value of CD so that smooth resolution and the objective of the Code can be achieved. Keeping the given provisions into consideration for the purpose of this research, it is now analysed herein different situations where attachment of property of the CD takes place and the implications thereon on the resolution.

ATTACHMENT OF PROPERTY UNDER PMLA AND BENAMI VS. CONCEPT OF IBC: JURISPRUDENTIAL APPROACH

The extinguishment of the criminal liability of the CD is apparently important to the new management to make a clean break with the past and start on a clean slate. The purpose of valuation and thereby resolution, demands the CD to transparently present all the liabilities, including those of criminal nature. It is the duty of the prospective cant as well as the RP to have on the table, a fair and transparent fact sheet of the CD. This concept is not new and even existed in the case of mergers and acquisitions under the Companies Act 2013, where due diligence for the purpose of valuation was made. It is to ensure that true and fair value can be ascertained and importantly wrongdoers are not allowed to get away. They remain liable.[12] While in this process, it is reminded that any criminal proceedings, complaints or such allegations, will be always in the name of an individual or a living person. It will not be directly affecting the CD, which makes it a good proposal for the resolution applicant to take up the CD and start afresh. But anyhow, any liabilities, and complaints, against the CD, will affect the value of the assets, market standing, goodwill, and overall profitability.

Various enactments in Indian law exists, where the assets of the CD are attached, seized, confiscated, or auctioned as well, to name a few Prevention of Money Laundering Act, 2002 (PMLA) and Benami Transactions (prohibition) Act, 1988 (Benami Act).

PMLA has provisions relating to presumptions and the onus of proof. The presumption against the accused or third party is good enough to detonate the onus of the officials under the PMLA Act. It must be noted that the presumptions are absolute, and the burden to ascertain the same otherwise lies on such a person. If the person is acquitted, then the attachment or retention shall cease to exist and in case the attachment becomes final, the property shall be confiscated. The order of confiscation of property shall result in the vesting of property with the Central Government (hereinafter referred to as CG), free from all encumbrances. CG shall appoint a person as an administrator of the property for management of the same. This implies that the property no more belongs to the CD, thereby reducing the overall assets of the CD.

These examples of statutes that penalize not only the owners and the wrongdoer of an organization but also confiscate the assets/ properties are where the assets of the CD are directly in question.

The question here arises that even though such cases may be termed as criminal prosecutions and are against the individuals but are still damaging the value of assets and have a severe impact on the goodwill of the CD. It can be said that the CD is punished for the wrong-doing of the director/promoter or person from the ex-management. The purpose of IBC and as discussed, the concept of Moratorium is brought into the picture to save the CD from any such situations.

For instance, cases whereas attachment of property by the executive authorities like Enforcement Directorate (ED) before moratorium and confiscation after/during CIRP may be imposed. In such cases section 32A of the Code is very clear and it prohibits any proceedings while the CD is under moratorium, but attachments under PMLA or Benami Act is imposed. National Company Law Appellate Tribunals (NCLAT) have held that section 32A(2) of the Code will not apply to the provisional attachment order under the PMLA.[13] Also, the ED /other investigating agencies do not have the powers to attach assets of a CD, once a resolution plan stands approved and the criminal investigation against the CD stands abated.[14] It was straight away held that section 32A creates a specific bar with respect to proceedings that may be initiated under the PMLA. Moreover, section 32A cannot possibly be read as being applicable prior to a resolution plan being approved or a liquidation measure being enforced. The objective and intention of the Code is to provide a free hand to the creditors if the properties of the CD are attached then it will jeopardize the liquidation process.[15] These jurisprudences developed have depicted a strict view where no such attachments will prevail over the proceedings under the Code.

Another situation, where the attachment of property by ED after initiation of liquidation proceedings took place. In such a case,[16] it was propounded that if the authorities were allowed to pass orders of attachment for those properties which are acquired by bidders in a liquidation process, then the same would be contrary to the interest of value maximization of the CD's assets as it significantly reduces the chances of finding a resolution applicant or a bidder in liquidation. The bench noted that it is only that property that is obtained directly or indirectly as a result of criminal activity that can be classified as proceeds of crime. In the present case, there was no explanation regarding the properties that were sold to the petitioners being proceeds of crimes especially since these assets were neither overseas nor belonged to the group companies.

This brings us to a very important question as to whether the Code prevails any such other laws, especially in cases of conflict. In the case of Bhushan Power and Steel Limited (BPSL) was facing insolvency proceedings under the IBC. However, the ED had also initiated proceedings against the company under the PMLA for alleged money laundering activities. The ED had attached the assets of BPSL under the PMLA, which prevented the RP from taking over and managing those assets as part of the insolvency process. The committee of creditors (CoC) of BPSL challenged the attachment of the assets by the ED and argued that the PMLA should not take precedence over the IBC. The Supreme Court, in its judgment, held that the PMLA and the IBC are two separate and distinct legislations that operate in different spheres. The court further held that the IBC is a special law that takes precedence over the PMLA, as the former provides a comprehensive mechanism for the resolution of insolvency and bankruptcy. The court also clarified that the attachment of assets by the ED under the PMLA would not affect the rights of the CoC under the IBC. The RP appointed under the IBC would be entitled to take over and manage the assets of the company, including those that had been attached by the ED.

High Court has taken a similar view in by saying that (a) a resolution plan in regard to CD has been approved by AA, (b) same has resulted in a change in management of the CD, and (c) the change in management is in favour of persons who are not related to party of CD, immunities under section 32A of the Code cannot be denied to the CD.

To protect the assets of the CD, the court in a criminal appeal also held that after approval of the resolution plan by AA, in the light of section 32A, the criminal proceedings under section 138 of the NI Act will stand terminated only in relation to the CD. The date when the AA came to approve the sale of the CD as a going concern, the cessation as contemplated under section 32A did and would be deemed to have come into effect.

Very clearly it was held that there is no conflict between PMLA and the Code, and even if a property has been attached in the PMLA which is belonging to the CD, if CIRP is initiated, the property should become available to fulfil objects of the Code till a resolution takes place or sale of liquidation asset occurs in terms of section 32A.[17] NCLAT in its order dated February 17, 2020 while approving the resolution plan with some modifications, on the issue of attachment of assets by ED, observed:

> Mere assertion of the Directorate of Enforcement in its reply, that it needs to further investigate the matter to examine or comment if there has been any abetment or conspiracy by the Appellant establishes that it has no reason to believe on the basis of material in possession of Directorate of Enforcement, as on date, that meets the criteria under Section 32A (1) (b) of the 'I&B Code' for denial of immunity to the Appellant and the 'Corporate Debtor'.

However, it also said the ED and other agencies are free to proceed against the promoters and past directors of CD. Against this order appeal filed by ED before Supreme Court is pending for final decision.

There are also few arguments that say that IBC being the later law prevails, being *Lex posterior* (a later law prevails). In various Supreme Court judgments including, but not limited to *Pioneer Urban Land and Infrastructure Ltd. v. Union of India (IBC vs RERA*) it was held that special laws containing non-obstante clause will prevail over the prior law.

The observation of Hon'ble High Court is:

> The statutory injunct against the invocation or utilisation of the powers available under the PMLA was thus ordained to come into effect only once the trigger events envisaged under Section 32A came into effect. The Legislature thus in its wisdom chose to place an embargo upon the continuance of criminal proceedings including action of attachment under the PMLA only once a Resolution Plan were approved or a measure in aid of liquidation had been adopted.[18]

There have been various cases in this respect. The ED passed the provisional attachment order in respect of the 'specific assets' subsequent to the sale to the petitioners/ auction purchaser in the auction. On the issue, of whether the assets acquired by the auction purchaser can, at all be said to be 'proceeds of crime' as defined in section 2(1)(u) of the PMLA, High Court of Gujarat set aside the attachment order of ED; observed that the bidders would not acquire on the presumption that the assets were acquired because of criminal activity. Such presumption would be contrary to the principle of value maximation of CD's asset[19] and by such order, the Code prevailed.

Contrarily, another High Court order where 49 bank accounts of the CD were provisionally attached by the ED after the commencement of the CIRP. It was held that the provisional attachment of properties does not violate section 14 of the Code. PMLA seeks to subserve a larger public policy imperative and is an enactment representing 'a larger public interest, namely the fight against crime'.[20] In this case, the provisional attachment order issued prior to CIRP, both actions are being simultaneously carried out as both the IBC and PMLA operate in their own spheres.

CONCLUDING REMARKS

The jurisprudence in this area is still developing. There are few factors that various courts and tribunals have laid in deciding the cases. There is no straight jacket formula to decide which law will prevail in case of attachment of property of the CD.

Summarising the same:

a) The event of attachment of property order is important, whether it is before the initiation of CIRP proceedings or after the same, whether it is before the resolution plan or during the approval.

b) In case the offense is committed by the CD or any member in its personal capacity, then the liability on the individual culprit remains, it is only the CD who is relieved.

c) The evidentiary value must be conclusively ascertained before attaching a property in case of a CD under CIRP.

The principle followed behind it has been to uplift the economy, run the sick units, resolve the companies, and pay off the debts. This is to promote the flow of funds in the economy and remove the deadlocks, which might be created by attachments over property under any other statutes. The enactment of the Code with the given intent behind it, has been anticipated to even reduce the crime rate by not leaving behind the individuals who are punished by removing the control and management from their hands. The focus remains to take punitive actions against the culprit minds and keep the assets free in the market for growth, flow, and development.

[1] *Binani Industries Limited v. Bank of Baroda & Anr.*, Company Appeal (AT) (Insolvency) No. 82 of 2018.

[2] *Swiss Ribbons Private Limited and Another v. Union of India and Others* [(2019) 4 SCC 17].

[3] *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors.*, Civil Appeal No. 8766-67 of 2019.

[4] *Asset Reconstruction Company (India) Ltd. v. Tulip Star Hotels Ltd. & Ors.*, Civil Appeal Nos. 84-85 of 2020.

[5] *Dr. P Mahalingam v. Muthoot Fincrop Ltd.*, Company Appeal (AT)(Insolvency) No. 146 and With Company Appeal (AT)(Insolvency) No. 1121 of 2020.

[6] *Alchemist Asset Reconstruction Company Ltd. v. Hotel Gaudavan Pvt. Ltd. & Ors.*, Civil Appeal No. 16929 of 2017.

[7] *Jet Aircraft Maintenance Engineers Welfare Association v. Shri Ashish Chhawchharia RP for Jet Airways (India) Ltd.*, Company Appeal (AT) (Insolvency) No. 628 of 2020.

[8] *Anand Rao Korada v. Varsha Fabrics (P) Ltd. & Ors.*, Civil Appeal Nos. 8800-8801 of 2019.

[9] *Canara Bank v. Deccan Chronicle Holdings Ltd.*, CA (AT) (Ins.) No. 147 of 2017.

[10] *Tayal Cotton Pvt. Ltd. v. State of Maharashtra & Ors.*, Criminal Writ Petition No. 1437of 2017.

[11] The Insolvency and Bankruptcy Code (Amendment) Act, 2020.

[12] *Manish Kumar I v. Union of India & Anr.*, Writ Petition (C) No.26 of 2020 with other writ petitions.

[13] *Raj Kumar Ralhan v. Deputy Director, ED and Ors.*, IA No. 54 of 2020 in CP (IB) No. 43/07/HDB/2018.

[14] *JSW Steel Ltd. v. Mahender Kumar Khandelwal & Ors.,* CA (AT) (Ins.) No. 957 of 2019 and other appeals.

[15] *M/s Packwell (India) Ltd. v. M/s Emgee Cables and Communication Ltd.*, IA No. 15/JPR/2022 in CP No. (IB)-601/ND/2018.

[16] *Welspun Steel Resources Private Limited v. Union of India*, R/Special Civil Application No. 19387 of 2022.

[17] *The Directorate of Enforcement v. Manoj Kumar Agarwal & Ors.*, CA (AT) (Ins.) No. 575 and 576 / 2019.

[18] *Rajiv Chakraborty RP of EIFL v. Directorate of Enforcement*, W.P (C) 9531/2020, CM APPL.30578/2020 (Direction) CM APPL.22986/2022 (amendment).

[19] Supra Note 16.

[20] Supra Note 18.

06

Use of Technology to Improve NCLT Functioning

- Rajasekhar V. K.

Much has been said about exploring the possibility of using artificial intelligence in the legal field in general and judicial decision-making in particular. In this article, the author suggests a few ways in which the processes envisaged under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) can perhaps be speeded up.

SIMPLIFICATION OF PROCESSES AND PROCEDURES

The first of these involves simplification of processes. Right now, for filing an application with the Adjudicating Authority (AA), Form 1 (in the case of financial creditors), Form 5 (in the case of operational creditors) and Form 6 (in the case of corporate applicants) of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 are used. These are typed, filled in, scanned into pdf and thereafter uploaded on the National Company Law Tribunal (NCLT) website along with the documents referred to. Some of the NCLT benches still insist on having two sets of physical copies filed into court after scrutiny of the online application, even though the 'Document Management System' was intended precisely to avoid physical documents. Additionally, the creditor is also required to file a copy of the application with the Insolvency and Bankruptcy Board of India (IBBI).

Many a times, the creditor filing the application makes it a point to load the application with documents that are wholly unnecessary for determination of debt and default. One of the applications ran into 12 volumes running into roughly 2000 pages, where a determination could have been arrived at with one-third of those. Often, due to such voluminous applications, the AA had to ask the counsel appearing for the creditor in order to determine the date of default on which the fate of the application hinges. All of this can be avoided if the whole process can be re-engineered.

RE-ENVISIONING THE IBC ECOSYSTEM

The application can be made online, with the system insisting on certain fields to be necessarily filled in. The corporate identification number and registered office address can be populated from the Ministry of Corporate Affairs (MCA) portal. The Information Utility certificate can also be procured from the National E-Governance Services Ltd. (NeSL) portal. This can be easily accomplished, considering that the there are two public repositories of financial information – the MCA portal and the NeSL's. Doing away with the bulky paper book will make the system truly online.

MAKING THE E-COURTS PLATFORM TRULY PAPERLESS

Come to think of it, at the moment, the E-Courts platform of the NCLT is little more than a storage medium. It is not even being used to generate the cause list except as a first draft. However, if the suggestion to make the filing process completely online is implemented, then a suitable algorithm can be quickly coded so that as soon as the application is rendered defect-free, the application is numbered and an intimation thereof is sent to the registered email address of the corporate debtor (CD) as well as the email addresses of each of the whole-time directors of the CD, under the signatures of the officer in charge of the registry. This will eliminate the need to have the hearing notices sent out after the application is listed in the supplementary list for the first time. This will also nip in the bud pleas that no intimation was received by the CD in respect of the application in question and do away with the practice of obtaining affidavits of service.

Once an order is approved by the AA, it is technically ready for pronouncement the next working day. This process can be automated to append the digital signatures of the members on the day of pronouncement automatically, with a digitally signed copy thereof being sent directly to the counsel on record.

A digitally signed copy of the order ensures integrity and immutability of the order, while at the same time reducing litigation costs. The data stored on a blockchain is completely reliable, since it brings both auditability and traceability owing to time-stamped cryptographic records. Therefore, Appellate Court Rules can be suitably modified so as to eliminate the need for certified copies in appeal proceedings, where digitally signed copies of orders are available on a blockchain from the AA. As a matter of fact, the Appellate Authority's registry can also check the authenticity of the order if blockchain technology is used. This will enable creation of a composite judicial repository which will help data mining and analysis, leading to greater transparency.

It is interesting to note that the Hon'ble Supreme Court, in its Vision Document for Phase III of the E-Courts project, is also considering a shift to an 'ecosystem approach' by simplifying procedures, creating a foundational digital infrastructure, and putting in place a new institutional and governance framework.[1] It also envisions granting legal recognition to digital copies of all documents.[2]

STRUCTURE OF THE ORDERS

The orders passed by the AA in various applications under the Code, do contain certain standard elements. If a common structure or smart template is proposed for such standard elements, then this can be populated by the computer itself from the online application. The AA will have to apply its mind only to the decision on the application. This will save considerable time of the law research associates and stenographical assistants. Standardisation through a defined architecture and module will reduce the time taken by the AA in preparing and pronouncing orders, eliminate redundancy and will help in data analysis.

THE DRUDGERY OF PERIODICAL REPORTS ON THE CIRP

Regulation 40B of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 mandates the filing of Form CIRP-7 within three days of the due date of completion of the activity in terms of the timelines stipulated in the table given therein. Although there is no provision either in the Code or the Regulations, there is a convention of the AA ordering the Insolvency Professional to file periodical reports with the AA also. The periodicity of the filings made with the AA depends on the whim of the bench concerned. In some cases, it is as little as every 15 days. This must be regulated either by the NCLT itself or by the IBBI.

Unlike in the case of liquidation, where progress reports are mandated by Regulation 15 of the IBBI (Liquidation Process) Regulations, 2016, there is no mandate under the law to file periodical reports of the corporate insolvency resolution process (CIRP) with the AA. The CIRP does not envisage supervision of process by the AA. Hardly anything is done with such reports, other than gathering dust in the NCLT precincts. Therefore, the AA must not see itself as a supervisor of the process when such is not the mandate of the law.

If at all the AA requires such reports, then it can easily take it from the IBBI, with which such reports are in any case reposited. This will sub-serve two purposes – one is reducing the number of interlocutory applications that are listed, thus bloating the cause list unnecessarily, and the second is that the AA will not waste its time on such applications, helping it focus on the more pressing matters at hand.

Thus, blockchain will have at least the following uses: (a) managing the filing and thereafter the court records; (b) removing data redundancies; (c) ensuring the integrity of the documents filed; (d) managing court judgments; and (e) providing a court architecture where the litigants, their counsel and the Appellate Courts can rely on the judgment hosted on the platform itself, without having to apply for certified copies thereof.

The whole chain will move as follows: Re-engineering of the business process, building systems that can link the repositories of MCA and NeSL with the re-engineered E-Courts module that is currently made available to NCLT, culminating in an open, inter-operable, unified, scalable digital infrastructure ecosystem. This will be a far cry from the existing system where NCLT, National Company Law Appellate Tribunal (NCLAT) and IBBI work in their own insulated silos.

BENEFITS FOR STAKEHOLDERS

What are the benefits for stakeholders? The aim ultimately is to bring in transparency, automation of the case allocation process so as to avoid the tendency to seek favourable courts within the same bench, improve predictability of the process, reducing arbitrariness and potential for mischief in the registry, and save valuable time of the support staff by template-driven orders which will capture the facts from the online application filed. A combination of these will reduce arbitrariness in court decisions, better data analytics which will help a member know if there has been a prior decision on similar facts by any other bench, and automate the process of pronouncement subsequent to approval by both members.

For the litigant and their counsel, such an approach will provide better scheduling mechanisms, increase access to courts by making hybrid hearings the norm rather than the exception, proactive alerts and hearing information, seamless filing services and service of prior notice to the opposite party, access to the filed copy of the application without additional service requirements, better utilisation of their time, and greater access to information about similar cases before other benches.

For the AA, there will be better data analysis, leading to improved support for decision-making, intelligent scheduling of cases, seamless access to search the digital documents, and availability of legal precedents in real time. In case of transfer of matters from one bench to the other, there will be no need to move the physical files because configured access can be granted or revoked to particular bench members.

For the support staff, digital filings will reduce errors and increase effectiveness of the registry, ready-built templates for orders, freeing up time for proper legal research, for which the law research assistants were recruited in the first place.

For policy makers and administrators, there will be better analysis, which can provide for targeted intervention in the types of cases that tend to clog the judicial system itself. Such targeted intervention may be either by way of legislative changes or streamlining procedures. Additionally, if there is irrefutable evidence of default in NeSL and the application is within limitation, policy makers could consider introducing right to summary judgment in favour of the creditor in matters of admission to CIRP.

The additional spin-off benefit from eliminating paper-based processes will have a positive impact on the environment.

[1] "Digital Courts: Vision and Roadmap", Phase III of the E-Courts Project Committee, Supreme Court of India, p. 21.

[2] *Ibid*, p. 41.

07

The Case for an Integrated Digital IBBI Portal for Quick & Timely Resolution of Corporate Insolvencies

- T. V. Mohandas Pai and
Shankar Jaganathan

SNAPSHOT TODAY

The need for a quick and equitable system for resolving insolvencies is vital for sustained economic progress, as business failures are an inherent part of the free market economy, as risk-taking fuels rapid economic growth. While the time taken to complete insolvency resolution process measures its efficiency, its effectiveness is measured by the quantum of creditors' claims recovered. In the last seven years since the current Insolvency and Bankruptcy Code, 2016 (IBC/Code) came into being, there is significant progress made in resolving credit defaults as reflected in the status of the corporate insolvency resolution processes (CIRPs) initiated, as captured in Table-1.

Table1: Status of CIRPs Initiated
(From inception of the new Code till March, 2023)

Outcome	Description	CIRPs initiated by			
		FCs	OCs	CDs	Total
Status of CIRPs	Closure by Appeal/Review/Settled	264	688	7	959
	Closure by Withdrawal u/s 12A	232	609	7	848
	Closure by Approval of Resolution Plan	380	241	56	677
	Closure by Commencement of Liquidation	927	896	207	2030
	Ongoing	1109	831	113	2053
	Total	**2912**	**3265**	**390**	**6567**
CIRPs yielding Resolution Plans	Realisation by Creditors as % of Liquidation Value	182.7	125.8	147.5	168.5
	Realisation by Creditors as % of their Claims	34.2	17.6	18.3	31.8
	Average Time taken for Closure of CIRP	613	632	541	614
CIRPs yielding Liquidations	Liquidation Value as % of Claims	6.4	9.1	8.6	7.0
	Average Time taken for Closure of CIRP	450	390	456	476
Note: This excludes four cases wherein applications filed by the RBI were admitted u/s 227 of the Code.					

Source: IBBI Quarterly Newsletter, Jan-March, 2023.

In addition to the basic objective of the Code of improving the effectiveness and efficiency of insolvency resolution process, there is also an additional objective that seeks to promote sound business decision making to prevent business failures by changing from 'debtor-in-possession' regime to 'creditors-in-control' mode that puts the promoters of business, the chief decision makers, at a disadvantage during the CIRP by removing them from their decision making role. This change was reinforced by amending the Companies Act, 2013 through a notification issued by Ministry of Corporate Affairs (MCA) on October 25, 2017, that eliminated the need for shareholders 'approval to implement resolution plans that are finalised as part of the CIRP and approved by the Adjudicating Authority (AA).

Indications of the desired behavioural change by corporate borrowers can be seen from the 848 cases where the CIRP was withdrawn by settling with the creditors thereby ensuring the corporate borrower retained the control of their companies. Of the 848 cases, 55% of the cases involved amounts of less than ₹ 1 crore, 24% involved amounts ranging from ₹ 1 - ₹ 10 crore, and another 13% involved cases from ₹ 10 - ₹ 50 crore, which together accounts for 92% of the withdrawn cases. Does this indicate success in bringing about behavioural change in smaller value corporate insolvencies?

Moving on to the effectiveness front where resolution plans are approved, 31.8% realisation by creditors of their claim, i.e., ₹ 2.86 lakh crore realised out of ₹ 8.99 lakh crore claimed, is to be seen in the context of ₹ 1.70 lakh crore liquidation value of the assets, and ₹ 2.65 lakh crore fair value of the assets at the time of initiating CIRP. Likewise, where liquidation was the chosen option, the liquidation value was only 7% of the amount claimed, reinforcing the point that liquidation is the least preferred option in resolving insolvencies for all parties concerned, both the corporate debtor (CD) and its creditors.

A critical point to be noted while interpreting the effectiveness of insolvency resolution system using percentage of claims realised as the indicator is the fact that quality and marketability of the assets and the insolvency process, are both significant if not equal contributors in determining the realisation percentage achieved. However, when measuring the efficiency of insolvency resolution system, the contribution of CIRP is substantial, if not the most significant factor.

The Code provides for completion of the CIRP in 180 days, which can be extended further by a maximum of 90 days to 270 days. Seen in this context, 614 days taken for closure of CIRP where resolution plans were approved, and 456 days taken for closure of liquidation plan is much longer than what is envisaged in the statue. Further, with regard to the ongoing CIRPs, over 1300 cases, which constitute 64% of the ongoing cases, that are outstanding for more than 270 days indicate that these cases too would go beyond the statutory time limit for resolution. This indicates that there is a pressing need for significantly reducing the timelines for closure to bring them within the statutory timelines.

EFFICIENCY DETERMINANTS

This large scope for improvement does not immediately translate to any easy methods by which improvement can be achieved, considering the detailed process and consultation outlined in the Code and the large number of players involved. The process outlined in the Code is quite detailed, as is rightly to be expected for a process involving multiple parties with large amounts at stake. At a high-level, the process envisages over 20 steps involved in CIRP as listed in Table-2.

Table 2: Model Timeline for Completing CIRP in 180 days

Step	Days	Activity
1	T	Commencement of CIRP and appointment of Interim Resolution Professional (IRP)
2	T+3	Public announcement inviting claims
3	T+14	Submission of claims under section 12(1)
4	T+21	Verification of claims
5	T+23	Report certifying constitution of committee of creditors (CoC)
6	T+30	First meeting of CoC
7	T+30	Resolution to appoint Resolution Professional (RP) by CoC
8	T+47	Appointment of Registered Valuers (RVs)
9	T+54	Submission of information memorandum (IM) to CoC
10	T+75	Invitation for expression of interest (EoI)
11	T+75	RP to form an opinion on preferential and other transactions
12	T+90	Submission of claims under section 12(2)
13	T+90	Submission of EoI
14	T+97	Verification of claims under section 12(2)
15	T+100	Prepare provisional list of resolution applicants
16	T+105	Submission of objection to the provisional list
17	T+105	Issue of request for resolution plan, evaluation criteria and IM
18	T+115	Final list of resolution applicants
19	T+115	RP to make a determination on preferential and other transactions
20	T+135	RP to file an application to AA for appropriate relief
21	T+135	Receipt of resolution plan
22	T+165	Submission of CoC approved resolution plan to AA
23	T+180	Approval of resolution plan to AA

Source: Annexure I, Model Timelines, Research Paper titled "Assessment of Corporate Insolvency and Resolution Timeline", IBBI website

In addition to the 20+ defined steps, there are three tiers of stakeholders with specific roles who need to perform their part efficiently for the quick completion of insolvency process.

- At the core are the principal parties who have their financial interest at stake- the CD, and their creditors both financial and operational, who need to provide the basic information that is needed to kickstart the insolvency process;

- Following them are the facilitators – IRP/RP, RVs, and the resolution applicant, who are the catalyst for moving the process through its distinct stages and taking it to its logical conclusion; and
- On top overseeing the entire process are the three regulators, the MCA who regulate the CD before and during the insolvency process, the Insolvency and Bankruptcy Board of India (IBBI) who oversee the entire insolvency process with National Company Law Tribunal (NCLT), as the AA who validate and endorse the entire CIRP. In listed entities, the Securities and Exchange Board of India (SEBI) and the stock exchange in which they are listed to, play a role.

Each of the participants have their own Information Technology solution to enable their role in the insolvency resolution process. CDs as operating businesses have their own ERP systems and compliance software that help them run their business, which provides the information that is required for putting together the IM, a key input for preparing the resolution plan. The IRP/RP being relatively a new profession created in India use a combination of multipurpose office software and digital document storage systems to comply with the requirements of the Code and file compliance reports. The three regulators and the AA have their own electronic filing systems and the E-courts platform for discharging their roles in the CIRP.

In addition, the IBC has created a new player, Information Utilities (IUs) who are required to be registered under the Code to perform the role as an information anchor by collating the required information from participants, enabling its authentication by the counterparty and providing periodic reports.

Despite islands of rich IT solutions used by multiple stakeholders involved in the CIRP, the challenge for managing and sharing information still persists resulting in the process getting significantly slowed down. As rightly pointed out by the IBBI Chairman Ravi Mital *'The present challenge is that there is little or no technological interactions between these pillars/ institutions. The portal/ systems of the institutions are all disparate and mostly work in silos with limited exchange of information. There is a need for these systems to be integrated and inter-linked to each other in a structured manner to streamline their interactions'*.

PERFECT RECIPE FOR AN IT PORTAL

The presence of a defined process, combined with the existence of multiple stakeholders operating in their individual information silos coupled with the need to exchange information and store the information exchanged provides the perfect recipe for an automated digital platform that can cut the process time involved from the present 600+ days average required for completing the CIRP to the desired target of 180 days.

Designing the automated digital platform for CIRP needs to consider the three fundamental benefits to be realised of creating a 'Single Source of Truth' for all the stakeholders involved, enabling realtime exchange of information, and create an audit trail of timelines and response of different stakeholders that is essential for continuous improvement of the CIRP.

At a broad design level, the digital platform for insolvency resolution needs to have the following features. A dedicated and tentative portal that integrates all the disparate IT systems should be designed to achieve the following:

a) Comprehensive Coverage: The portal should cover all activities involved in the CIRP starting from initiation of CIRP, to appointment of IRP, capturing creditors' claims and their validation, formation of the CoC and their meeting activities, provision to create and store the IM prepared, creating the invitation for EoI, provision to capture resolution applicants, preparation of the resolution applicants list, criteria and storing of the evaluation process resulting in selecting resolution applicant, receipt of resolution plan from the resolution applicants and its acceptance by the CoC, filing of the resolution plan with the AA and getting its approval.

b) Automated Data Transfer: Multiple stakeholders are involved who need to provide data and also validate the data provided by their counterparties, to prevent multiple source of data, there is a need to automate data transfer from the IT systems involved by using APIs without any human interface as the information is already available with other stakeholders in their IT system. This may need integration with IUs who capture the claims filed by the creditors and validation of the same.

c) Report Creation: Enable creation of CIRP specific reports like the IM, creation of CoC, maintenance of the minutes of the CoC, invitation for EoI, selection criteria and evaluation of the resolution applicants, filing of resolution plans and capturing the correspondence/information shared with the AA. This will ensure an audit trail of the creation and finalisation of all the documents created in the CIRP that can be used for analysis by the AA, other regulators and at a later point of time, after defined period for cool-offs, by academicians for research purpose.

d) Electronic Communication: Provision for capturing email exchanges between different stakeholders of seeking information and obtaining the same, formation of CoCs and the maintenance and circulation of its minutes and critical correspondence with the resolution applicant. This will be key to ascertain the responsiveness and define model schedule that can be prescribed on an ongoing basis.

e) User Group Defined Rights: Create user group defined rights for different categories of participants like the CD, financial creditors, operating creditors, IRP, RP, members of CoC, resolution applicants and give them appropriate rights to view different categories of information stored in the software and the right to add, edit, delete, view and download the information as desired. Further the regulators could also be provided access to the finalized documents to speed up the process of CIRP.

f) **Filing with AA**: Provision to file application to the AA from the system, which will ensure both tracking of the application filed and storage of the digital copies of the filings for future reference.

g) **Audit Trail**: Create a comprehensive log of all the activities undertaken in the portal with the facility to segregate and view it based on specific user category, user name or specified period. This can help significantly in fixing responsibility and accountability of different stakeholders.

h) **Digital Repository**: An outcome of this digital portal would be the autocreation of a safe and secure repository of all the records created. These records can be stored for the period defined in the Code or as defined by the AA as the case demands.

i) **Realtime Dashboard**: With the portal in use, informative real-time dashboards on the status of a CIRP along with its progress can be benchmarked against the model timelines and also the average timelines taken for that category of cases providing a system for self-monitoring by the stakeholders concerned.

Creation of this portal can significantly reduce the timeline for resolution from the current 600 days plus to the mandated 180 days and with experience even short period. While other steps like reducing the majority required in the CoC for taking critical decisions from 75% to 66%, and introduction of fast-track resolution process for companies with total assets not exceeding ₹ 1 crore by reducing the time limit from 180 days to 90 days, and a maximum of 135 days, have been introduced, the next big step in cutting timelines for CIRP will not need amendments to the statute, but a significant investment towards digitization. A byproduct of increasing its efficiency by cutting the lead-time for closure is in increasing its effectiveness, as distressed assets depreciate rapidly and any reduction in timeline for closure can significantly increase the creditors claim realisation.

NEED FOR PUBLIC INVESTMENT

While the need for this software portal based on its significant value add is loud and clear, its market size is not attractive for commercial players even when the global market is considered not just for the larger established software companies, but also for the start-ups to pursue it.

Further, the significant role played by the three regulators -MCA, IBBI and NCLT combined with the need for information exchange between the different participants also further dilutes the case for commercial development of this portal. Given the socio-economic need to speed up economic growth and development, making our CIRP system more efficient is essential. Significant benefits for the economy coupled with the lack of immediate economic benefits from the investment made, makes a strong case for public investment in creating this portal, much like the UPI (Unified Payment Interface) initiative that has transformed the instant payment system heralding significant gains for ease of trade, especially for small value transaction, which is benefiting crores of Indians.

UPI, the real-time and mobile-enabled instant payment system, allows users to transfer funds between bank accounts using a simple interface. UPI is the result of public initiative launched in 2016 by establishing the National Payments Corporation of India (NPCI), as a section 25 not for profit company, jointly promoted by the Reserve Bank of India and the Indian Banks' Association. UPI enables users to link multiple bank accounts to a single mobile app and make instant payments using a virtual payment address, a mobile number, or a QR code. UPI's widespread acceptance and use was visible with over 30 crore transactions taking place each day in the month of July, 2023. Its success is not just limited to India and has inspired similar initiatives in other countries like Singapore's PayNow, Thailand's PromptPay, and Hong Kong's Faster Payment System to adopt it.

Given this precedent of making public investment in utilities that have a longer gestation period, there is a strong case for a similar investment to be initiated by IBBI along with the other two associated regulators MCA and SEBI and with the participation of the two stock exchanges - the National Stock Exchange and the Mumbai Stock Exchange to develop this portal. The successful operation of this portal could add to the global digital leadership provided by India to countries across the world, similar to UPI initiative, thereby contributing to not just India's growth and development but also enabling this economic growth and development in many other countries of the world.

08

Blockchain Technology – Can it be a Panacea for the Ills Ailing the IBC

- Akaant K M

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC /Code) has been one of the most radical legal movements in the economic sphere of India. The shift from the debtor-in-possession to creditor-in-control model, the suspension of the management of the corporate debtor (CD) and the resolution process conducted under the oversight of the committee of creditors (CoC) by a Resolution Professional (RP) are all hallmarks of the Code and the revolution that was brought about by these sweeping provisions of the statutory law of the IBC. One further issue that it sought to address was a critical gap in the existing information infrastructure, especially information pertaining to the existence of a debt and default.[1] The same was sought to be addressed by a system of Information Utility (IU), where a regulated entity will make available all the relevant information to all stakeholders in resolving insolvency and bankruptcy.[2]

Now with almost seven years of experience of the Code in hand, coupled with a parallel boom in the expansion of blockchain technology and the currency that is run utilizing this technological model; we have at our hand an ever-evolving ecosystem and the opportunity to seek benefit of the same.

The purpose of this short article is to share pointers on the interplay of the IBC with blockchain technology. Firstly, the article will discuss the advent of IU and the role envisioned for it in the evolution of money; secondly the article would look into the issue of delay at various stages of the Code, and the current limited growth of IUs in the system, then the article would discuss the technology of blockchain using an illustration and its key features that could decongest the bottlenecks hampering the efficacy of the IBC and finally the article will conclude with closing comments.

BIRTH OF INFORMATION UTILITY (IU)

The Report of the Bankruptcy Law Reform Committee (BLRC), which formed the foundation of the Code, discussed the problem with the then existing framework where the financial liabilities of corporate entities was not getting timely and duly reported; despite there being specific legal mandate under the Companies Act, 2013. The issue arising therefrom could be understood in a point wise format:

1. Generally, an entity has two sets of liabilities: (a) Financial liabilities, which pertain to secured and unsecured loans, debt securities amongst others and (b) Operational liabilities, which pertain to payments due towards employees, payment due for raw materials purchased amongst others.

2. Now, an entity is statutorily mandated under the Companies Act,

2013 to prepare and file their financial statements, which shall give a true and fair view of the state of affairs of the company.[3]

3. However, experience has shown the same to be not that effective in terms of compliance. But more importantly, the same still does not vest the information directly into the hands of a creditor.[4]

This is where an IU is envisioned to come into picture. Prior to the IU, there is an already existing framework pertaining to registration of a charge by companies with the Registrar of Companies (RoC),[5] Credit Information Companies,[6] and Central Registry under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)[7]. All these frameworks are born out of different statutory regimes and mandate differential functions and obligations of disclosures.[8] The BLRC, cognizant of the same, notes that the statutory provisions governing these databases may involve restrictions on access to relevant stakeholders who may be involved in an insolvency and bankruptcy resolution case. Therefore, the natural progression would be to bring all these various statutory creations under unified umbrella of an IU and allowing access to such information collected by these databases to all the relevant stakeholders facilitating faster and effective implementation of the various provisions and processes under the IBC. To that end, as the BLRC puts it, *'an enabling framework may require amending respective laws to enable access of the information to the relevant parties during the resolution processes under the Code'*.[9]

To conclude, the foundational idea behind the IU is:

a) To provide information relating to a debt and as a corollary, its default with increased symmetry (in other words, accessible to creditors and debtors alike),

b) To provide information, which is accurate, verified, and

c) To provide information, which is easily locatable for any entity, including a court of law or a RP or a Liquidator to assess if there is a debt and the event of default.

The same ultimately seeks to facilitate a brisk and accurate establishment of a default by an entity. For instance, section 7 of the IBC stipulates that a financial creditor (FC) may file an application for initiating corporate insolvency resolution process (CIRP) against a CD before the Adjudicating Authority (AA) when a default has occurred. The aforesaid creditor is to support their application with a record of the default recorded with the IU, which then the NCLT is to ascertain if there is an existence of a default from the records of an IU.

The constitutionality of the concept of IU was subsequently challenged in the case of *Swiss Ribbons*,[10] where it was argued that:

(a) there can be private IUs whose sole object would be to make a profit; and

(b) the said IU is not only to collect financial data, but also to check whether a default has or has not occurred. It was argued that such certification by the IU agency cannot substitute for adjudication.

Rejecting the challenge, the Apex Court referred to the provision of section 214(e)[11] of the IBC (amongst other provisions), to conclude that the safeguards are already in place as an IU is to satisfy itself that the information provided as to the debt is accurate, which is done by giving a notice to a debtor who then has an opportunity to correct such information.

An IU is to collect information regarding liabilities obtained through the filings of contracts and securities from financial firms and intermediaries. At this point, a general template could also be seen by which the IU starts collecting the information regarding the liabilities of an entity. Consider a following sample of the same - the one received from National E-Governance Services Limited (NeSL):

NeSL

To

Sh. _______________

Greetings from National E-Governance Services Ltd (NeSL), India's first Information Utility.

A financial information has been submitted to NeSL-Information Utility as per particulars furnished below. As per the submitted information, you are connected to the mentioned credit facility as a debtor.

Particulars of Submitted Information	
Submitter's Name	(Name of the Creditor)
Information as on (date)	xxx
Information submitted on (Date & time)	xxx
Type of Debt	Financial
Type of Information	Data
Unique Debt ID	xxx
Submission ID	xxx
Loan Status	Active/Inactive

As per the provisions of the IBC & IBBI (Information Utilities) Regulations, 2017, the information furnished by one of the parties to the debt needs to be verified and authenticated by all the other connected parties.

The process of verification & authentication is to be done electronically on the NeSL-IU Platform. In order to register and view the above debt information please click on the hyperlink **Click here**. You will be registered/ logged in based on details provided by the reporting bank/financial institution.

The reported financial information will be viewable which you can verify and authenticate by following the undermentioned procedure:

1. In case you find the information furnished as correct, select the "Yes" option to confirm that you are accepting all the above details.
2. In case you find any discrepancy or have any dispute about any of the details, please select "No" option. You will be prompted to provide reason of dispute as remarks in the space alloted.
3. Click "Authenticate" button in either of the above cases.

When you click "Authenticate" button, you will be prompted to electronically sign the information by affixing digital signature with your DSC or e-Sign with Aadhaar based OTP.

We solicit your early action in the matter on receipt of this e-mail.

In case of need for any clarification / guidance / assistance in this regard, please contact out Help Desk on our Toll Free Numbers: 1800 599 2345, 1800 266 2346 or one-mail id helpdesk@nesl.co.in. or helpdesk-mum@nesl.co.in.

Thanks and Regards,

Information Utility

National E-Governance Services Ltd.[12]

The above template clearly provides a way for a debtor to raise a dispute regarding any misinformation. Resultantly, the vision for IUs was upheld by the Apex Court and subsequently brought to life by registered IUs such as the NeSL.

BOTTLENECKS IN IBC - DELAYS

The problem of delays in adjudication in the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) system was statistically noted by the Standing Committee on Finance in its 2021 Report 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions', wherein the following stats had emerged:

a) About 13,170 cases remain pending with the NCLT, involving an approximate amount of ₹ 9,00,000 crore;

b) 71% of these cases have been pending for more than 180 days;

c) The average time taken for the process under the IBC is 1.6 years.[13]

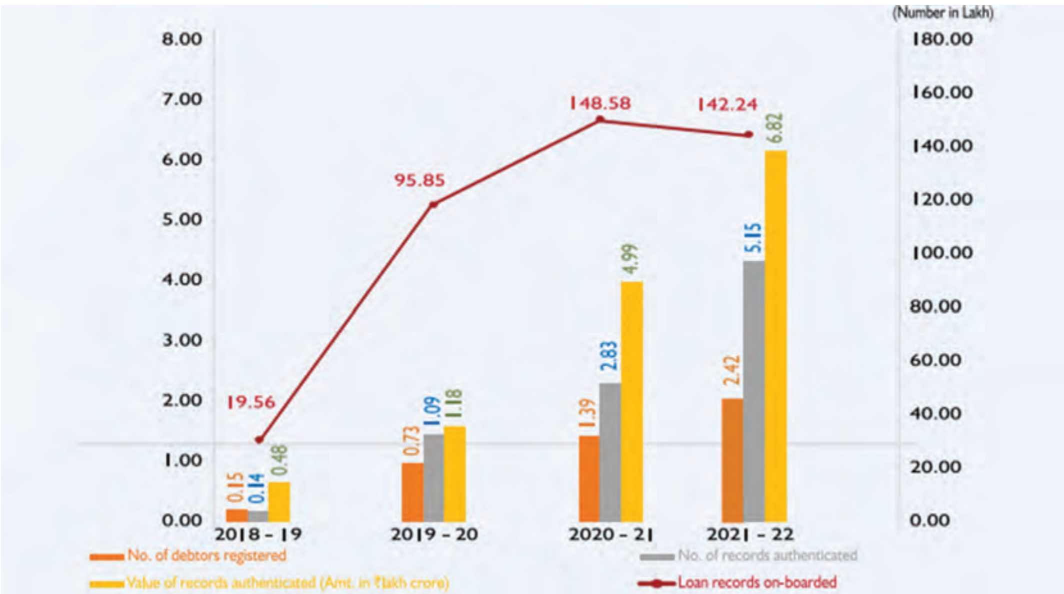
These figures do project a huge improvement over the state of affairs existing at the time, when the Code was implemented, for in 2017, the average time taken for the process under the IBC was 4.3 years.

However, to rest on these laurels would miss a crucial success story of Indian economy and democracy, which as the BLRC in its Report calls it, is 'leapfrogging'.[14] Our nation has been a late entrant to the infrastructural growth. In the evolution of our nation since independence, we did not witness a major shift from an agricultural economy to a manufacturing economy; which usually is the case with the growth of major developed economies. However, on the back of computer technology we have found growth in the service and information technology sector. One does not need to go far to see the capabilities of our nation in harnessing the potential of technology that the United Payments Interface, or popularly known by the acronym, the 'UPI'.

This leapfrogging was what the BLRC had envisioned would get unlocked for the field of insolvency and bankruptcy by the introduction of IUs. The BLRC postulated, *'[t]here is a possibility to go to the top decile of countries of the world, by utilising computer technology, and often doing things in ways which are not seen even in advanced countries as of 2015.'*[15]

However, it is yet to be explored and unfastened. Currently, we have NeSL, as the only IU registered under the IBC, that acts as the repository of all debt and default information provided by the creditors and offers authentication /verification services for such debt and default.[16]

As per the information sourced from the Quarterly Newsletter (Jan-March 2022) of the Insolvency and Bankruptcy Board of India (IBBI) by the Insolvency Law Committee in its May, 2022 Report, indications of an increasing trend in the amount of information being stored and recorded with NeSL are noted. As of the end of March 2022, ₹ 5.15 lakh loan records amounting to ₹ 6.82 lakh crore had been authenticated with NeSL.[17]



While it is certainly the case that as far as financial debts in form of loans are concerned, it is a growth in the record available with the IU, the above misses a major gap in the practical reality, which is that the IU still does not majorly include:

(a) The operational liabilities;

(b) The debt owed to individuals who may have lent to a corporate entity or individuals; and

(c) The liabilities which are not verified and authenticated by a counter party, when an IU entity sends a request to such party to authenticate/verify the debt.[18]

Back in 2015, when the BLRC firstly proposed IUs, it had noted the following:

> While both types of creditors can trigger the IRP under the Code, the evidence presented to trigger varies. Since financial creditors have electronic records of the liabilities filed in the Information Utilities of Section 4.3, incontrovertible event of default on any financial credit contract can be readily verifiable by accessing this system. The evidence submitted of default by the debtor to the operational creditor may be in either electronic or physical form, since all operational creditors may or may not have electronic filings of the debtors liability. Till such time that the Information Utilities are ubiquitous, financial creditors may establish default in a manner similar to operational creditors.[19] [Emphasis Added]

Cut to the present, the Insolvency Law Committee released its May 2022 Report, wherein the Committee had explored the issue as to whether delays at the admission stage could be reduced by facilitating greater reliance on the records of debt and default that are stored and authenticated by registered IUs. It was noted that relying on IU authenticated records that indicate undisputed information of default would enable the AA to spend less time on verification of default and allow for quicker disposal of CIRP applications.

The Committee then had recommended:

> 2.10 … the Committee decided that financial creditors that are financial institutions, and such other financial creditors as may be prescribed by the Central Government, should be required to submit only IU authenticated records to establish default for the purposes of admission of a Section 7 application. Where such IU authenticated records are not available, and for all other financial creditors, current options of relying on different documents for establishing default may remain available. Suitable amendments to Section 7 may be made for this purpose. Further, where creditors submit IU records to prove default, the Adjudicating Authority should dispose of the application speedily and should limit its scrutiny to determining if default for the purposes of commencing a CIRP has occurred.

What stood out was also the realisation that the need for operational creditors (OCs) to be brought under the same template, and how we are still underequipped for the same:

> 2.11 It was also noted that requiring operational creditors to submit financial information to IUs may be too burdensome at present. Consequently, the Committee agreed that, with further development of IU infrastructure in due course, it may be considered if operational creditors should be similarly mandated to rely on IU records for establishing default. [Emphasis Added]

Now, the consequence of this severely limited impact of the IU could be seen at the following stages:

(a) Pre-admission delays:

While the pre-admission delays have been attributed to the umpteen hearings/ adjournments given to the CDs to file reply/ rejoinders to other parties',[20] it is submitted that the same is inherent in an adversarial system of adjudication. As a matter of policy making, any suggestion of disallowing filing of a rejoinder, or any suggestive model of penalizing filing of an interlocutory application would severely introduce a chilling effect on any party, no matter the genuineness of their claim or efficacy of their argument.

(b) Inability of any forum to strictly comply with the provision of sections 7(4), 9(5) and 10(4) of the IBC:

The proceedings under the IBC are time bound and summary in nature.[21] Therefore a detailed adjudication is not envisioned when an application is filed seeking initiation of resolution process against a debtor.[22] All that an AA is required to do is to ascertain the existence of debt and default within 14 days from the receipt of an application and on being satisfied that there is debt and default and the application is complete, the AA is mandated to pass an order of admission of the application on merit.[23]

In JK Jute Mills Co. Ltd. v. Surendra Trading Company,[24] a question with respect to sections 7(4) and (5),[25] 9(5)[26] and 10(4)[27] was posed as to whether the timeline prescribed for admitting or rejecting petitions under these respective provisions is mandatory or directory. While section 7(5) pertains to petitions by FCs, section 9(5) pertains to OCs and section 10(4) stipulates terms for CDs. The respective provisos provide for seven days' time to the applicant-creditor to rectify the defect in the petition.

The NCLAT held that while provisions laying down 14-days' time to admit or reject the applications are procedural in nature and hence directory, the corresponding provisos laying down 7-days' time for rectifying any defect in the application are mandatory.

The same was overturned partially by the Supreme Court in appeal in *Surendra Trading Company v. Juggilal Kamlapat Jute Mills Co. Ltd.,*[28] wherein it was held that even the provisos to sections 7(5), 9(5) and 10(4) are directory.

It is also to be noted that the IBC stipulates that if an application is not decided by the AA or the Appellate Tribunal within the time frame stipulated in the IBC for the respective application, then the President of the NCLT and the Chairperson of the NCLAT respectively, may extend such stipulated timeline up to 10 days.[29]

The restricted success of the IU model has meant that the provision of sections 7(4), 9(5) and 10(4) remains an utopia only.

(c) Post admission of CIRP - countless impediments for an IRP/RP/ Liquidator in collating and including claims of creditors:

The IBC requires an Interim Resolution Professional (IRP)/RP/Liquidator to manage the affairs of a CD and collate claims of the creditors of a CD.[30] Section 18(b) of the IBC then stipulates that the IRP is to receive and collate all the claims submitted by the creditors to them. On the other hand, section 25(2)(e) mandates the RP to maintain the updated list of claims. Section 15(1)(c) provides that a public announcement of the CIRP made under section 13 should contain the last date for submission of claims.[31]

Now pertinently, the recent Report of 'Colloquium on Functioning and Strengthening of the IBC Ecosystem' notes the following issues with respect to problems faced by IRP/RP/Liquidators:

> **(b) Interactions of IP with stakeholders**
>
> 2.7 After admission of application, the process is carried out by the IP and requires interactions with debtors (for taking custody of assets/ records), creditors (for claims), RVs (for valuation of assets), Committee of Creditors (CoC) (for meetings of CoC, agenda, decisions), authorised representatives (AR) of class of creditors, potential resolution applicants [for EoI, Request for Resolution Plan (RFRP), resolution plans] and auction purchasers (for notice, auction). Further, the outcomes of these interactions need to be reported to regulators (IBBI and IPA) and to NCLT (during liquidation).
>
> 2.8 All these interactions are conducted by the IPs at various kinds of platforms and information about these processes are stored mainly in excel sheets. In case of friction between two parties in an interaction, there are claims and counterclaims about which version of information is correct.
>
> 2.9 If the above interactions are conducted on an integrated platform, the information can flow efficiently and quickly throughout the system. It will help the NCLT in quickly establishing the facts as there will be a

> single source of truth in the whole system. Another advantage of all the stakeholders being present in the same system will be instantaneous service of notices etc. thereby curtailing process delays at NCLT.[32] [Emphasis Added]

The Report then recommends the following:

> Table 2.1 Snapshot of the modernization features
>
> …
>
> • Developing portal for submission of authenticated claims through IU
>
> …
>
> Paragraph 2.21
>
> …
>
> iv. Further, the IBC platform will need to be linked to IT systems of other institutions such as CBIC in respect of verification of goods and services provided by OCs to the company, CBDT, CBIC, EPFO, ESIC, MSME, etc. so that their claims can flow directly, and transactions of claimants can be verified easily.[33]

So, in effect the issue of collation, verification, and inclusion of claims have on occasions gotten inevitably stuck for numerous reasons, be it delayed submission of claims[34] or claims getting disputed.[35] Adding on to the same, a claimant also has the remedy of challenging the decision (collation) of their claim by the RP before the NCLT. The position of law herein is fairly settled that any person aggrieved against the decision of the IRP/RP rejecting or modifying the claim submitted by any of the creditors may approach the NCLT under section 60(5).[36] Therefore, any person aggrieved against the order of an IRP/RP may approach the NCLT under section 60(5), IBC. In *S. Rajendran v. Jonathan Mouralidarane,*[37] when the RP rejected the claim, the claimant went in appeal under section 60(5) and the NCLT reversed the decision of the RP and allowed the total claim.[38]

Resultantly, the litigation could get prolonged.

BLOCKCHAIN AND RISE OF A MORE DECENTRALISED SYSTEM – A PANACEA FOR THE ILLS OF OUR RECORD KEEPING

A lot of discussion around blockchain technology goes un-understood on account of the huge popularity gained by the term ‘Crypto’. While crypto currency is a form of digital money, blockchain is the technology that provides it a platform to run. Just the way the RBI prints and records the currency notes that an individual ultimately uses and owns; the blockchain technology provides a base for its users a way to keep their transactions using digital money accounted for and in a trustworthy system.

However, unlike RBI, blockchain technology is a peer-to-peer database. In other words, there is no central authority keeping track of the money issued by it, nor there is any bank that could attest how much money one has in their account. The most famous example of this blockchain based peer-to-peer database is the Satoshi Nakamoto's Bitcoin Blockchain, which is a database for the first modern cryptocurrency, i.e., the Bitcoin.[39]

It is now, easy to imagine cryptocurrency as an asset/property of a debtor amendable to be sold by a Liquidator in auction or to be included under the list of assets of a CD by an RP for the purposes of preparing an information memorandum,[40] the technology underlying crypto currency has tremendous potential to be tapped.

It is submitted here that the Blockchain database could form basis for the future of IU that could basically reduce the litigation timeline to a real time resolution of disputes.

Consider the following illustration to understand how algorithms work to verify the digital transaction. Ram is playing cards and in his hand he has 5 of spades (5th card out of a total of 52 cards), 7 of hearts (20th card out of a total of 52 cards), and 9 of diamonds (35th card out of a total of 52 cards). The same would be reflected in the following manner in a digital ledger:

Serial No. in the Digital Ledger	**Card Value**
1	5
2	20
3	35

Now, let us add Kalpana and Krishan to the illustration, therefore, now Ram will not have consecutive serial numbers in the ledger. The ledger would now also include cards that are dealt to Krishan and Kalpana.

The revised ledger for Ram's cards would now look like the following table:

Serial No. in the Digital Ledger	**Card Value**	**Previous Card**	**Next Card**
1	5	0	10
10	20	1	15
15	35	10	-

So, now for anyone to know what Ram's cards are, they are to see serial number 1, 10 and 15 in the ledger. Since, it is easier for hackers to alter this, another column gets added here:

Serial No. in the Digital Ledger	Card Value	Previous Card	Next Card	Sum Value
1	5	0	10	5
10	20	1	15	25
15	35	10	-	55

So, if anyone were to alter the value of Ram's cards, they would still be required to alter the sum value as well. This process of 'doubly linked list' with the added check sum safeguard is also found to be prone to tampering as anyone who has sufficient access rights to change card values could also alter the checksums to cover up his work.

What the bitcoin blockchain database, which is used by the Bitcoin crypto currency as its ledger, does is that it takes this method system and builds upon a more complex encryption, known as hashing. Here, the transactions made by one person get recorded, say, in an encrypted code titled '28FNJ238NW2'. This particular format is not hackable or amenable to reverse engineering. Here, no singular mathematical formula could be devised as the encrypted code cannot be turned back into original data using any matching mathematical process. Each block's hash value is based on the previous block's hash value, all the way to Satoshi Nakamoto's Block 0.

Serial No. in the Digital Ledger	Card Value	Previous Hash	Block Hash
1	5	-	0
2	20	0	0002891ea56db
3	35	0002891ea56db	573812asnjrqn21378
4	12	573812asnjrqn21378	1238781sj2782

What is more crucial is that such database is not restricted to any central bank or financial institution, rather such database is distributed from a peer-to-peer as blockchain database works on peer-to-peer format. Therefore, no single person could unilaterally alter the transaction value in any entry, as such a hacker would have to simultaneously change copies of the database that are stored on hundreds or thousands of computers. This makes the data reliable and indisputable.

This form of technology could allow the onboarding of all types of debts, including financial, and operational debts and allow for the following advantages:

a) Faster reference of determining whether a debt is there;

b) During CIRP, an IRP/RP could easily collate all the transactions from this digital ledger;

c) The decentralized format of this database means that the entire IU format where an IU entity is mandated to get the debt recognized from the concerned debtor and creditor, would not be required to do so. The transaction simply gets recorded with a coded/hashed ID and the same forms an invariable proof of an admitted transaction between two entities.

CLOSING REMARKS

The world of blockchain technology is here to stay and the position with respect to a peer-to peer database stands to further affirm the democratic principles of our nation. It is submitted that the revolution brought about UPI technology should encourage us to improve upon the IU model, and provide for a more reliable system (which is in essence more democratic) where transactions, no matter their nature, get recorded with more precision and easily at the fingertips of the very entities/individuals who are concerned with those very transactions, eliminating the need for any third-party centralized entity to seek any subsequent verification/ authentication (it must be mentioned here that IU as a concept, however, does decentralize the process of accessing and using the information collected). If the scope of this technology is harnessed by our economy, then for starters the potential to reduce disputes as well as the potential for increased ease of business, could result in an efficient economic, and legal system. The bottlenecks of our legal system can be witnessed easily in litigation in the form of money suits, as well as cases under the Negotiable Instruments Act, 1881. The same is ironic since given the nature of dispute, i.e., pertaining to a quantifiable and tangible commodity, such disputes should have been easily verifiable. The issue has now spilled to plague our insolvency and bankruptcy law mechanism and threatens to bring a sense of lethargy that echoes of the times bygone.

[1] Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, Report 2015, para 4.3.5.

[2] Section 7 of IBC:

Section 7 - **Initiation of corporate insolvency resolution process by financial creditor**.

(1) A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government, may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

Explanation - For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor.

(2) The financial creditor shall make an application under sub-section (1) in such form and manner and accompanied with such fee as may be prescribed.

(3) The financial creditor shall, along with the application furnish:

(a) **record of the default recorded with the information utility** or such other record or evidence of default as may be specified;

(b) the name of the resolution professional proposed to act as an interim resolution professional; and

(c) any other information as may be specified by the Board.

(4) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), ascertain the **existence of a default from the records of an information utility** or on the basis of other evidence furnished by the financial creditor under subsection (3).

… [Emphasis Added]

[3] Sections 128, 129, 137, 248 of The Companies Act 2013,

[4] Supra Note 1, para 4.3.3.

[5] Section 77 of The Companies Act 2013:

Section 77 – **Duty to register charges, etc**.

(1) It shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation:

…

(2) Where a charge is registered with the Registrar under sub-section (1), he shall issue a certificate of registration of such charge in such form and in such manner as may be prescribed to the company and, as the case may be, to the person in whose favour the charge is created.

(3) Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016 (31 of 2016), as the case may be, or any other creditor unless it is duly registered under sub-section (1) and a certificate of registration of such charge is given by the Registrar under sub-section (2).

(4) …"

"Section 81 - **Register of charges to be kept by Registrar**.

(1) The Registrar shall, in respect of every company, keep a register containing particulars of the charges registered under this Chapter in such form and in such manner as may be prescribed.

(2) A register kept in pursuance of this section shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

[6] Section 14 of The Credit Information Companies (Regulation) Act 2005:

Section 14 - **Functions of a credit information company**.

(1) A credit information company may engage in any one or more of the following forms of business, namely:

(a) to collect, process and collate information on trade, credit and financial standing of the borrowers of the credit institution which is a member of the credit information company;

(b) to provide credit information to its specified users or to the specified users of any other credit information company or to any other credit information company being its member;

(c) to provide credit scoring to its specified users or specified users of any other credit information company or to other credit information companies being its members;

(d) to undertake research project;

(e) to undertake any other form of business which the Reserve Bank may, specify by regulations as a form of business in which it is lawful for a credit information company to engage.

[7] Sections 20 and 22(1) of SARFAESI:

Section 20 - **Central Registry**.

(1) The Central Government may, by notification, set-up or cause to be set-up from such date as it may specify in such notification, a registry to be known as the Central Registry with its own seal for the purposes of registration of transaction of securitisation and reconstruction of financial assets and creation of security interest under this Act.

(2) The head office of the Central Registry shall be at such place as the Central Government may specify and for the purpose of facilitating registration of transactions referred to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.

(3) The Central Government may, by notification, define the territorial limits within which an office of the Central Registry may exercise its functions.

(4) The provisions of this Act pertaining to the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the Registration Act, 1908 (16 of 1908), the Companies Act, 1956 (1 of 1956), the Merchant Shipping Act, 1958 (44 of 1958), the Patents Act, 1970 (39 of 1970), the Motor Vehicles Act, 1988 (59 of 1988) and the Designs Act, 2000 (16 of 2000) or any other law requiring registration of charges and shall not affect the priority of charges or validity thereof under those Acts or laws.

Section 22 - **Register of securitisation, reconstruction and security interest, transactions**.

(1) For the purposes of this Act, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to - (a) securitisation of financial assets; (b) reconstruction of financial assets; and (c) creation of security interest.

...

[8] See for instance, Credit Information Companies (Regulation) Act, 2005, Part VI deals with "Information Privacy Principles and Furnishing of Credit Information", including the purpose for which the credit information may be used, restriction on such use and disclosure thereof. The same also deals with the period for which such information may be maintained, manner of deletion of such information and maintenance of records of credit information.

[9] Supra Note 1, para 4.3.6.

[10] *Swiss Ribbons (P) Ltd. v. Union of India*, Writ Petition (Civil) No. 99 of 2018.

[11] Section 214 (e) of IBC stipulates:

> Section 214 - **Obligations of information utility**.
>
> For the purposes of providing core services to any person, every information utility shall-
>
> ....
>
> (e) get the information received from various persons authenticated by all concerned parties before storing such information;

[12] The Template is derived by the author of the article from his personal record.

[13] "Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions", para 20, Part II para 5.

[14] Supra Note 1, para 4.3.

[15] *Ibid.*

[16] Report of The Colloquium on Functioning And Strengthening of the IBC Ecosystem, para 2.3(iv).

[17] Report of The Insolvency Law Committee, May, 2022, para 2.7.

[18] IBC, section 214(e) stipulates, for the purposes of providing core services to any person, every information utility shall get the information received from various persons authenticated by all concerned parties before storing such information.

See also FAQs available on NeSL website, which under the head of "53.What is the process of authentication?", specifically states that '*[a]s per the provisions of IBC, 2016 & IU Regulations, the financial information furnished by one of the parties connected to a debt needs to be verified & authenticated by all other parties connected to the debt by affixing their digital signature or Aadhar based e-signature. NeSL would be storing the authenticated information with it, for providing access to the persons specified in the Act, during the Insolvency Resolution Process*'.

[19] Supra Note 1, para 5.2.1.

[20] Supra Note 16, para 3.21.

[21] *Committee of Creditors through Shri Ashish Kumar Srivastava v. Sanjay Gupta and Anr.*, Company Appeal (AT) (Insolvency) No. 115-116 of 2021; *Vibrant Buildwell Pvt. Ltd. v. Dilwara Leasing and Investment Ltd.*, Company Appeal (AT) (Insolvency) No. 58 of 2021.

[22] *Vibrant Buildwell Pvt. Ltd. v. Dilwara Leasing and Investment Ltd.*, Company Appeal (AT) (Insolvency) No. 58 of 2021.

[23] *Aditya Birla Finance Ltd. v. Sintex Prefab and Infra Ltd.*, Company Appeal (AT) (Insolvency) No. 121 of 2021.

[24] 2017 SCC OnLine NCLAT 3.

[25] Sections 7(4) and (5) of IBC states:

> 7. Initiation of corporate insolvency resolution process by financial creditor. —
>
> (4) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor under sub-section (3).
>
> (5) Where the Adjudicating Authority is satisfied that —
>
> (a) a default has occurred and the application under sub-section (2) is complete ... , it may, by order, admit such application; or;
>
> (b) default has not occurred or the application under sub-section (2) is incomplete ... , it may, by order, reject such application:
>
> Provided that the Adjudicating Authority shall, before rejecting the application under clause (b) of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the Adjudicating Authority. [Emphasis added]

[26] Section 9(5) of IBC states:

9. Application for initiation of corporate insolvency resolution process by operational creditor. — ...

(5) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), by an order —

(i) admit the application and communicate such decision to the operational creditor and the corporate debtor if, —

(a) ... , if any.

(ii) reject the application and communicate such decision to the operational creditor and the corporate debtor, if ... professional:

Provided that Adjudicating Authority, shall before rejecting an application under sub-clause (a) of clause (ii) give a notice to the applicant to rectify the defect in his application within seven days of the date of receipt of such notice from the adjudicating Authority. [Emphasis added]

[27] Section 10(4) of IBC states:

10. Initiation of corporate insolvency resolution process by corporate applicant. —

(4) The Adjudicating Authority shall, within a period of fourteen days of the receipt of the application, by an order —

(a) admit the application, if it is complete; ... or

(b) reject the application, if it is incomplete ... :

Provided that Adjudicating Authority shall, before rejecting an application, give a notice to the applicant to rectify the defects in his application within seven days from the date of receipt of such notice from the Adjudicating Authority. [Emphasis added]

[28] (2017) 16 SCC 143.

[29] Section 64(1) of IBC:

64. Expeditious disposal of applications. — (1) Where an application is not disposed of or order is not passed within the period specified in this Code, the National Company Law Tribunal or the National Company Law Appellate Tribunal, as the case may be, shall record the reasons for not doing so within the period so specified; and the President of the National Company Law Tribunal or the Chairperson of the National Company Law Appellate Tribunal, as the case may be, may, after taking into account the reasons so recorded, extend the period specified in the Act but not exceeding ten days.

[30] See for instance, section 17(2)(c) stipulates:

Section 17. Management of affairs of corporate debtor by interim resolution professional.

(1) ...

(2) The interim resolution professional vested with the management of the corporate debtor, shall —

...

(c) have the authority to access the electronic records of corporate debtor from information utility having financial information of the corporate debtor;... [Emphasis Added]

[31] The IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides for a detailed procedure as to whom and how can a claim be submitted before the IRP/RP for collation.

Regn. 6. Public announcement. — (1) An insolvency professional shall make a public announcement immediately on his appointment as an interim resolution professional.

Explanation. — “Immediately” means not later than three days from the date of his appointment.

(2) The public announcement referred to in sub-regulation (1) shall:

(a) … ;

(b) … ;

[26][(ba) state where claim forms can be downloaded or obtained from, as the case may be;

(bb)] … ; and

(c) provide the last date for submission of proofs of claim, which shall be fourteen days from the date of appointment of the interim resolution professional.

(3) …

Regn. 7. Claims by operational creditors

Regn. 8. Claims by financial creditors

Regn. 8-A. Claims by creditors in a class

Regn. 9. Claims by workmen and employees

Regn. 9-A. Claims by other creditors"

[32] Supra Note 16, para 2.3(iv).

[33] *Ibid.*

[34] See *Col. Sanjeev Dalal v. International Recreation & Amusement Limited*, CA-1084(PB)/2018 in C.P. No. IB-297(PB)/2018. Herein the applicants/allottees claimed to be unaware of the CIRP and hence were delayed in filing their claims. In this case, while the resolution plan was pending approval, the NCLT still condoned the delay and allowed the allottees to file their claims before the RP. See also *M/s. Ruchi Soya Industries Ltd. v. Union of India & Ors.*, Civil Appeal Nos. 447-448 of 2013.

[35] See for instance *Kotak Mahindra Bank Ltd. v. Amtek Auto Ltd.*, 2019 SCC OnLine NCLAT 1078, several claimants challenged the decision of the RP in collating their claims. The NCLAT took note of the fact that it has already ordered for liquidation of the corporate debtor since the successful resolution applicant has backed out. In light of this, the NCLAT in the present appeal held that there is no point in determining the correctness of the decision of the RP since they may now file the claim before the liquidator who, unlike the RP who is merely required to collate claims, is statutorily authorised to decide and adjudicate on the claims.

[36] Section 60(5) of IBC stipulates:

Section 60. Adjudicating Authority for corporate persons. — …

(5) Notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of —

(a) any application or proceeding by or against the corporate debtor or corporate person;

(b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and

(c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code.

[37] 2019 SCC Online NCLAT 758.

[38] See also *Golden Jubilee Hotels (P) Ltd.* v. *NCC Ltd.*, 2019 SCC OnLine NCLAT 337.

[39] For a lucid and coherent read on these terms, see the article titled "What Is Blockchain Technology and How Does It Work?".

[40] See for instance the judgment in *AA v. Persons Unknown* [2019] EWHC 3556 (Comm) UK, where bitcoin was found to be a property. See also UK Jurisdiction Task Force, Legal statement on cryptoassets and smart contracts, The Law Tech Delivery Panel (November 2019). See also *Copytrack Pte Ltd. v Wall*, 2018 BCSC 1709 (British Columbia Ruling). See also *B2C2 Ltd v Quoine Pte Ltd* [2019] SGHC(I) 3, where the Singapore International Commercial Court applied the doctrine of mistake in the context of cryptocurrency trading and automated contracts entered through computer programming.

09

IBC: The Challenge in Its Implementation & Legal Adaptations

- Ranbir Singh and Komal

INTRODUCTION

The Insolvency and Bankruptcy law is essential to an economy. These laws help in reorganization of the assorted assets of the businesses and also dissolution of these assets. Thus, bankruptcy laws form a vital cog in the wheel. However, there are specific challenges in the enforcement of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), which have been discussed in this article.

Until now, legal reforms in India have been based on doctrinal research and the serendipitous outcomes of litigation. Studies of law in action, empirical research, and impact analysis are evidently absent. This deficiency has been the subject of academic debate among legal scholars for four decades.

As Gibson observed (1982),[1]

> ..it is becoming increasingly recognized that the effectiveness of the law in the modern complex state is far too important to leave to chance or conjecture. With informed knowledge of the operation of previous laws and the potential consequences of proposed new legislation, both the legislature and the executive can have greater confidence in the proposed statute's purpose being accomplished. The conviction that reform is most effective when it is founded on solid knowledge rather than on the sands of ignorance is the primary reason for studying the effect of law on our society. Legal impact analysis is a tool that can be used in these endeavors.

Two components comprise legal impact analysis. The first is a study of the impact and effectiveness of legislative acts currently in force, and the second is a study of empirical data on the impact of judicial decisions. Governments have attempted to address this shortcoming by repealing obsolete statutes from books. However, in the absence of empirical data, 'law in action' studies, and impact analysis, purging the statute book of obsolete laws is a cosmetic exercise that contributes nothing to resolving the system's ills. There had been no systematic and continuous law reform based on empirical and socio-legal research reflecting what Eugen Ehrlich refers to as the living law of the people prior to the enactment of the Code. The IBC is reversing this trend by introducing a new wave of legal reforms that heavily rely on data and market indicators to ensure that the law remains relevant to contemporary economic and social realities. Thus, enactment of the IBC serves as a precursor to a new class of legal reform that reflects the people's living law. For many years, the Indian legal system lacked a robust and comprehensive insolvency and bankruptcy mechanism. However, with the enactment of the IBC, this long-felt need for credit market reform has been addressed. The Code reflects current market realities in the financial sector and is complemented by a robust ecosystem that enables policymakers and legal scholars to monitor the Code's implementation in ways that previous Parliamentary Acts did not. The Code is a piece of economic legislation that was enacted in response to our country's economic challenges in a fast-paced globalised economy. The Code is futuristic in design and is capable of accommodating rapid technological advancements that have a dizzying impact on financial markets. The Code was enacted at a time when legislators and members of the legal profession are confronted with novel challenges and opportunities previously new to the legal profession. Justice Holmes' prediction from more than a century ago that *'for the rational study of law, the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics'* will be tested by the provisions of IBC, as the decision to revive a firm will be based on sound economic principles in tune with market realities, rather than on the dry bones of black letter law. As a result, the Code places a high market on the wisdom of credit market participants by empowering financial creditors (FCs) to make the final determination regarding a business enterprise's prospects for revival or winding up. The Central Government implemented a continuous monitoring mechanism following the Code's enactment by establishing a Standing Committee, the Insolvency Law Committee (ILC), to address challenges that arise during the Code's operation. This has given the Code tremendous strength by energizing it to accomplish its stated objectives. No other Act of the Parliament or State legislature has garnered such prominence in terms of operationalizing and implementing the provisions of any law it has enacted. Perhaps the sole exception is the direct and indirect tax laws, which are based on extensive empirical data and feedback. Thus, IBC is set to alter the current legal framework, in which Acts of Parliament and State legislatures are not reviewed on a continuous basis and amendments to Acts are triggered in response to a difficulty arising from a judgement or in response to public demand. To appreciate the significance of IBC within the current legal framework, one must first consider the challenges confronting the legal profession and judges today as a result of the impact of technology and information deluge, as well as traditional judicial conservatism. Lee Loevinger, the founder of Jurimetrics research, lamented in 1949 that the only field of human activity in the last few centuries that has not developed significant new methods is law. According to him, the next step in man's progress must be from jurisprudence (which is merely speculation about law) to Jurimetrics (which is scientific investigation of legal problems).[2] As a result, individuals from all walks of life – particularly those without a legal education – are calling into question the time-honored methods of providing legal services. We live in an era when a traditional, conservative legal profession is increasingly being forced to justify its methods—and perhaps even its very existence; we live in an era when dissent against the established order is becoming normalized and widely distributed globally; and we live in an era when newcomers are rewriting the script and challenging established ways.[3] Recent technological and legal innovations triggered by the digital revolution and communication networks have already entered the legal discourse, including digital technology, Big Data, data analytics, algorithms, artificial intelligence, the Internet of Things, blockchain technology, judicial statistics, virtual court rooms, and online court hearings. A brief overview of technological advancements and their implications for law and law reform will help in understanding the new trend initiated by the Government with the enactment of the Code and the subsequent series of measures taken to ensure its effective implementation as part of the larger law reform movement.

VIRTUAL COURT ROOMS AND ONLINE COURT PROCEEDINGS

The advancement of digital technology and communication networks has enabled the judiciary to migrate to a digital environment and conduct trials and proceedings online. Tele-immersion can be used to create a virtual court, bringing all parties, including the judges, together in a tele connected digital environment that spans continents. Tele-immersion also enables the creation of a virtual court in which courts from different jurisdictions can convene jointly to decide cases across distances and time zones. For the following reasons, electronic communication via video, multimedia, and other virtual modes is gaining importance in the implementation of the IBC:

(a) When the provisions of Part III of the Code (relating to individuals and partnership firms) will be implemented, it will benefit individuals seeking redress under the IBC by allowing them to participate in online hearings rather than wasting time and energy travelling to remote Tribunals. This is critical because, 'in contrast to corporate insolvency, where businesses can afford to file and defend cases before National Company Law Tribunal (NCLT) located in select cities, individual insolvency will have a much broader reach, with individuals located in every remote corner of the country. They will be governed by the IBC and will be required to communicate with the relevant Debt Recovery Tribunal (DRT), which serve as Adjudicating Authority (AA) for individual insolvency. Since the IBC supersedes the Provincial Insolvency Act, 1920 and the Presidency Towns Insolvency Act, 1909, the IBC has amended the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act), authorising the DRTs to hold circuit sittings at district headquarters to facilitate access for litigants.[4] Nonetheless, litigants will be required to travel from remote locations to the district headquarters in order to access the tribunal. As part of e-governance, online filings, submissions, and hearings by DRTs will address this hardship and facilitate easy access to justice. Additionally, where the stakes are low, lawyers' intervention can be waived, and provisions for online mediation can be incorporated into the Act. With minor amendments to the RDB Act, DRTs are already empowered to accept electronic filing of documents and are digitally compliant to accommodate online hearings.

(b) Cross-border insolvency matters will necessitate collaboration and convening of bankruptcy judges from various national jurisdictions. A joint hearing entails that either court may also interrogate an individual who has appeared before the other court or permit one or more individuals to speak. The United Nations Commission on International Trade Law's (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) establishes effective mechanisms for resolving cross-border insolvency cases in order to advance, among other things, the goal of cooperation between courts and other competent authorities of the enacting State. The Model Law contains detailed provisions governing how concurrent proceedings between courts in different jurisdictions will be handled, which necessitates direct communication between the two courts. Additionally, it establishes joint hearings between the two courts. Articles 25 to 27 deal with communication between bankruptcy courts. To supplement the requirements of these Articles, the Judicial Insolvency Network Conference adopted guidelines for communication and cooperation between courts in cross-border insolvency matters in 2016. Annexure A is an interesting section of the guidelines because it contains guidelines for the conduct of joint hearings between courts of different jurisdictions. The ILC, which was established by the Ministry of Corporate Affairs (MCA), submitted its Report to the Government in October, 2018 with a matter to adopt the Model Law, which the Government is currently considering. When adopted, the Model Law will require the IBC to be amended appropriately to allow for joint hearings in cross-border cases between NCLTs and bankruptcy courts in other jurisdictions.

(c) COVID-19 is another crisis that has accelerated the growth of online court hearings. The pandemic has compelled members of the legal profession to readily accept virtual court proceedings. During the COVID-19 lockdown, the Supreme Court addressed the issue of delivering justice through order. In Re: 'Guidelines for Court Functioning Through Video Conferencing During COVID-19 Pandemic', a Bench comprised of Chief Justice of India Sharad Arvind Bobde, Justices D. Y. Chandrachud and L. Nageswara Rao issued a direction directing courts to take measures to minimise litigant's physical presence on court premises by adapting to social distancing guidelines.[5]

These guidelines were issued pursuant to an extra-ordinary exercise of jurisdiction under Article 142 of the Indian Constitution. The Supreme

Court also issued a press release in delivery to criticism about the continuation of virtual court hearings following the lockdown, stating that the goal of both the open court system and the virtual court system is to deliver justice. Additionally, the press notes state that *'Open Court hearings cannot be claimed as an absolute right, and the adjudication process itself does not require an Open Court'*. However, in the modern era, when we rely on technology for virtually every aspect of our lives, virtual court rooms cannot be considered 'antithetical' to the open court system. Additionally, it issued instructions on how to join video-conferencing/teleconferencing sessions for the purpose of hearing listed matters.

Additionally, the National Company Law Appellate Tribunal (NCLAT) issued a statement stating that: '*In order to contain the spread of COVID-19, and after considering the various instructions and advisories issued by the Government regarding coronavirus control and lockdown, the Hon'ble Acting Chairperson, NCLAT has decided that all urgent cases will be heard via video conferencing beginning June 1, 2020*'. As a matter, the NCLAT has issued a revised Standard Operating Procedure for Advocates/Authorized Representatives/Parties-in-Person for referring matters for hearing via virtual mode (Cisco Webex meeting platform) beginning August 4, 2020 and continuing until further orders. In *Deepak Kholsa v. National Company Law Appellate Tribunal and Ors.*,[6] the Delhi High Court held that the NCLT and NCLAT are free to regulate their own procedures for virtual hearings as long as they ensure that requests for links are considered fairly, transparently, and without arbitrary decision-making. When viewed in this light, online and virtual court hearings will become the norm in the near future, and the Code's provisions are sufficiently flexible to address these futuristic developments with minimal amendments.

DRAWBACKS OF THE INSOLVENCY AND BANKRUPTCY LAW

The time factor

Under the IBC, the corporate insolvency resolution process (CIRP) extends a time-limited mechanism that aids creditors in recovering debts. If a company fails to repay its creditors for past-due amounts, the creditors may bring the matter to the CIRP. A resolution process against the company for debt recovery purposes shall be initiated through the CIRP. The time factor is critical here, as section 12 states that the process must conclude within 180 days of the requisition's admission to the CIRP. The time for approval of resolution plan is at the discretion of the AA. However, regardless of the extensions granted, the resolution process should be completed within 330 days. There may be instances where the proceedings take longer than anticipated due to unforeseen circumstances; in those instances, a 90-day extension may be granted as specified in the Code. The NCLT Benches assigned to the cases are slightly unbalanced and meeting the 330-days deadline is not easy. It creates a great deal of inconvenience in these instances. Large corporations have a large number of creditors and are in financial difficulty.

Lack of adequate infrastructure

According to a Report presented to Parliament, over 10,000 cases remain unsolved in the Tribunal, which means they will remain before the NCLT until September, 2019. Lack of adequate NCLT benches and an ever-increasing number of cases before the IBC have stymied the process's swiftness. This could be extremely detrimental to India and also undermines the very purpose of the expedited resolution process.

Lack of Resolution Professionals

There is a severe shortage of Resolution Professionals (RPs). The Insolvency and Bankruptcy Board of India (IBBI) has almost 4,300 recorded Insolvency Professionals (IPs).[7] To qualify as an insolvency expert, an individual must have 15 years of experience as an advocate, a company secretary, a chartered accountant, or a cost accountant. Additionally, he must pass the IBBI exam in order to become a diligent IP whose credibility cannot be questioned before the Board.

BIG DATA, ALGORITHMS, ARTIFICIAL INTELLIGENCE AND DATA ANALYTICS IN JUDICIAL PROCESS - DATAFICATION OF INFORMATION

The term 'datafication' of information refers to the process of converting words to data, which opens up a plethora of uses and possibilities. It is not simply the conversion of analogue to digital information. It is much more than that. To 'datafy' a phenomenon is to convert it to a quantifiable form that can be tabulated, analysed, and turned into actionable information. To capture quantifiable information, i.e., to datafy, it must first be understood how to measure and record what we measure. This requires the appropriate tools. Additionally, it requires a desire to quantify and record. Both are necessary conditions for datafication, and there is already a substantial body of legal literature on data collection methods, scaling techniques in socio-legal research, aggregate data analysis, and data interpretation that enables the measurement of the impact of law and legislation. The emergence of judicial statistics as a distinct field of study, comparable to medical statistics, combined with recent advances in information processing tools, will provide a significant boost to law reform in the new millennium. As we progress toward datafication of the society's information substructure, the primary means of capturing, sharing, and disseminating information, as well as the systems for doing so, can be used to improve, refine, streamline, optimise, and turbo-charge our traditional ways of working. Additionally, our systems are becoming more pervasive, as handhelds, tablets, and laptops have come to dominate our lives, resulting in the emergence of the 'Internet Things', a term that refers to the incorporation of chips into everyday objects, allowing them to be directly controlled by humans and constantly connected via the internet.[8] All of these new developments have had a profound impact on the law, courts, and legal profession. Because it is possible to process such information using data analytics and artificial intelligence to address legal issues that have never been considered in human history.[9]

The IBC recognises that 'information asymmetry' is a critical barrier to fair negotiations and ensuring the resolution process moves quickly, and thus establishes a regulated Information Utility (IU) that will make all relevant credit information available to all stakeholders involved in resolving insolvency and bankruptcy. This function is carried out by IUs, which serve as repositories for all debtors' credit histories. Additionally, the Central Government has taken a slew of measures to advance the datafication process and address information asymmetry by amending the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002[10] (SARFAESI Act) and establishing a Central Registry to maintain records of secured asset transactions and a central database to integrate records of property registered under various regulations. This includes registrations made pursuant to the Companies Act, 2013, the Registration Act, 1908, and the Motor Vehicles Act, 1988. The Central Government may, by notification, extend the provisions of Chapter IV relating to the Central Registry to all creditors other than secured creditors as defined in clause (zd) of sub-section I of section 2, for the purpose of establishing, amending, or satisfying any security interest in any property of the borrower for the purpose of ensuring the borrower's timely repayment of any financial assistance granted by such creditor to the borrower. This is intended to be expanded by including a provision in the legislation requiring the registration of all security interests with a Central Registry. Finally, a Public Credit Records Authority is required to collect ancillary credit information available outside the banking system from designated service providers and make it available in a central data base to facilitate credit institutions' efficient credit decision making. Access to/data feeds from the following sources should be available to the proposed authority:–

(a) Data on tax defaulters / past-due status from tax authorities such as the Income Tax, the Goods and Services Tax Network (GSTN), the Employees' Provident Fund Organisation, and municipal corporations, among others.

(b) From the GSTN platform in process to the customer's tax, tax filing status, and overtax status, which are critical data inputs for the customer due diligence, loan appraisal, and monitoring processes.

(c) Enforcement actions brought under the SARFAESI Act or the IBC, all court orders, and regulatory actions issued by the Securities and Exchange Board of India, the Reserve Bank of India, the

Insurance Regulatory and Development Authority of India, and other economic law enforcement agencies such as the Enforcement Directorate, the Department of Revenue Intelligence, and the Economic Offences Wing, among others.

(d) From various regulatory websites and databases in order to obtain a consolidated view of customers' compliance with tax laws, regulatory orders and sanctions, and credit defaults, among other things.

The Central Government may be empowered to notify (a) statutory, regulatory, and other authorities under its control, and (b) in consultation with State Governments, local bodies, and statutory, regulatory, and other authorities under their control, in purpose to collect ancillary information. This Big Data would act as an early warning/alert system for lending institutions during the loan appraisal/monitoring process. The availability of such a database will enable credit institutions to make more efficient credit decisions. This is augmented by the interlinking of the NCLT and NCLAT websites to other government websites, which enables researchers and policymakers to obtain real-time information about the credit market.

According to Dru Stevenson and Nicholas J. Wagoner, Big Data invites lawyers to rethink their approach to law fundamentally by examining statistical patterns, predictors, and correlations in addition to the legal rules that purport to control outcomes—case law, statutory law, procedural rules, and administrative regulations.[11] Analyzing large sets of data is becoming increasingly feasible thanks to new techniques that combine traditional statistics and computer science. These techniques and algorithms developed by statisticians and computer scientists to search for patterns in data have the potential to yield a wealth of useful information if extraction methods can be developed. Brandeis successfully demonstrated the use of data to bolster legal arguments before a court in the famous United States Supreme Court case *Muller v. Oregon* (208 US 412).[12] The Supreme Court was asked to decide the constitutionality of Oregons law limiting the hours of female laundry workers. Brandeis, who later became a US Supreme Court Justice, used an innovative technique to make the point that excessive work was detrimental to workers health. He compiled a number of statistics from medical and sociological journals and included citations to the articles in his brief. The brief was significant in that it was the first to be submitted to the Supreme Court that relied heavily on non-legal evidence to substantiate its argument. Not only did the brief assist Brandeis in winning the case, but it also established a legal precedent in and of itself. Briefs citing non-legal data quickly became prevalent and were dubbed Brandeis Briefs. Big Data, augmented by Brandeis Brief, will be critical in committee of creditors meetings and the IBC litigation landscape. Thus, Big Data on credit market participants is readily available for IBC purposes. The ecosystems that surround the IBC and the implementation of its provisions through the use of modern technology and information tools serve as a model for how future legislation will be shaped by legal reform. Not only can the Government and Parliament quantify and calibrate the impact of IBC provisions, but they can also quantify and calibrate the impact of NCLT and NCLAT decisions in order to take appropriate remedial action. In light of the foregoing, the IBC is a cutting-edge piece of legislation that was drafted to leverage and capitalise on the benefits of modern technology. It also serves as a precursor to the new breed of legislation that will grace the statute book. Today, every department of the Government sponsors legislation that has a significant impact on the lives of citizens in a variety of ways. Numerous of them have a significant impact on citizens' liberties and rights. Once enacted, there is no mechanism for determining the effect of the laws unless they are challenged in court. Only when an affected person brings a legal challenge to the provisions is the department notified, and the Government response is limited to resolving the specific case at hand, rather than reviewing the entire Act. To accomplish this, it is necessary for each Ministry/Department charged with administering Parliamentary Acts pursuant to the Government of India Allocation of Business Rules, 1961, to undertake this exercise and include it in its Annual Report to Parliament. The MCA has already established a precedent by establishing a standing committee to review the Acts that fall under its jurisdiction, and other Ministries should follow suit.

CONCLUSION

The IBC was enacted in 2016 and has since been amended numerous times and subjected to numerous judicial interpretations, resulting in a substantial body of insolvency and bankruptcy jurisprudence that attests to the Code's vitality. There have been criticisms of the IBC's functioning, casting doubt on the law as a whole. That should not discourage us, as no Act of the legislature is perfect and cannot guarantee 100% success within a five or ten-year time frame. This is for two reasons. To begin, the IBC represents the transition from an older legal order to a new legal order, and tensions between the new and old legal orders are always high during such transitions. We are currently undergoing such a transition. The majority of the cases clogging the NCLT and for which the Code is being unfairly criticised as ineffective are legacy cases that arose prior to the IBC's enactment and were caused by the credit market's ills prior to its enactment. Because the IBC has addressed all of these concerns, the credit market will be restored to health once the backlog is cleared. Second, because Big Data on the Code's functioning is readily available, it is possible to measure and evaluate the effectiveness of its provisions, as well as to level criticism. It is not hyperbole to assert that no other law is as transparent as the IBC, with its effectiveness easily quantifiable and subject to evaluation by all stakeholders due to the availability of Big Data. All reform movements throughout history have encountered opposition, and the IBC is no exception. In this context, it's worth recalling Machiavelli's wise words:

> There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success than taking the initiative in introducing a new order of things. Because the innovator has for enemies all those who have done well under the old conditions and lukewarm defenders in those who may do well under the new. This reserve is due in part to fear of the adversaries, who have the law on their side, and in part to men's incredulity, who do not readily believe in novel ideas until they have had new experience with them.

The IBC is a crown jewel in the Indian statute book; it is a landmark piece of legal reform legislation undertaken by the Government of India that is likely to usher in a new wave of law reform that will heavily rely on Big Data, data analytics, and market indicators to keep the law current with economic and social realities and enable India to compete with Singapore as a major restructuring hub in Asia.

[1] Gibson C. (1982), "Legal Impact Analysis: The Ideal and the Practicable", Journal of the Indian Law Institute, Vol. 24, No. 4, pp. 837-847.

[2] Loevinger L. (1949), "Jurimetrics-The Next Step Forward", Minnesota Law Review; Loevinger L. (1963),

"Jurimetrics: The Methodology of Legal Inquiry", Law and Contemporary Problems, pp. 5-35.

[3] Mitchell K. (2017), "The Great Legal Reformation: Notes from the Field", Kindle Edition.

[4] Section 17(1A) (b), Amendment to Recovery of Debts due to Banks and Financial Institutions Act, 1993.

[5] Re: Guidelines for Court Functioning Through Video Conferencing During Covid-19 Pandemic; Suo moto Writ Petition (Civil) No. 5/2020.

[6] W.P(C) 7108, March 8, 2021.

[7] IBBI website.

[8] Ghosh B. (1982), "Scaling Techniques in Socio-legal Research", Journal of the Indian Law Institute, Vol. 24, No. 4, pp. 739–750.

[9] Gangrade K. (1982), "Methods of Data Collection: Questionnaire and Schedule", Journal of the Indian Law Institute, Vol. 24, No. 4, pp. 713–722.

[10] The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

[11] Stevenson D. and Wagoner N. (2015), "Bargaining in the Shadow of Big Data", 67 Florida Law Review, 1337, pp. 1340-1342.

[12] The Brandeis Brief, Louis D. Brandeis School of Law Library.

Part III

The Cornerstones

10

Embracing Regulated Self-regulation : A Novel Approach

- Asit Behera and Ritesh Kavdia

'The only limit to our realization of tomorrow will be our doubts of today'

- Franklin D. Roosevelt

INTRODUCTION

The year 2016 marked a turning point in India's economic landscape, as the long overdue reform for insolvency resolution was rolled out with the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code). With it, the need for a proficient and reliable insolvency profession emerged. To meet the twin objectives of maintaining high order of competence and character, a transformative decision was made to introduce a novel approach of 'regulated self-regulation', where a layer of the front-line regulator in the form of Insolvency Professional Agencies (IPAs) was introduced between the professionals and the Statutory Regulator i.e., the Insolvency and Bankruptcy Board of India (IBBI/Board).

The design of the system has its own share of challenges. In this paper, the authors delve into the intricacies of the regulated self-regulation approach adopted and examine the potential concerns and issues that might arise along the way. By exploring these challenges, the authors seek to gain a deeper understanding of the impact and implications of this policy choice. This paper analyses the regulatory framework, key concerns, and suggestions for improvement related to the regulated self-regulation approach adopted in the insolvency regime.

BACKGROUND

When the Bankruptcy Law Reforms Committee (BLRC) was formulating the Code, it considered that starting the Code with a strong regulatory regime for Insolvency Professionals (IPs) may be inimical to the profession's development. While designing the regulatory structure for the IPs, it considered the question of regulation versus development and observed that the Indian experience with self-regulating professional bodies (such as Institute of Chartered Accountants of India (ICAI), Bar Council of India and Institute of Company Secretaries (ICSI)) has been reasonably positive in the development of their respective professions and professional standards. However, the experience on their role in regulating and disciplining their members has been mixed. In comparison, financial regulators (such as Securities and Exchange board of India (SEBI) and Reserve Bank of India) have had greater success in preventing systemic market abuse and in promoting consumer protection. It recommended a new model of 'regulated self-regulation' for the IP profession as an optimal solution and establishment of a regulatory architecture that included the IPAs between the IPs and the Board. It argued that it would ensure a balance between the need for a strong, independent regulator and the benefits of self-regulation by professional bodies.[1] This proposed two-tier structure allows for a competitive market for IPAs under the Board, with these agencies functioning within a defined framework to foster their respective professions. They would be responsible for developing professional standards, monitoring and disciplining members, and taking necessary actions as per the Board's defined standards. If found inadequate, the Board could intervene. It proposed IPAs to function like miniature states, handling regulatory, executive, and quasi-judicial duties.

The BLRC further suggested the regulatory framework to foster competition among multiple IPAs to enhance efficiency. Striking a delicate balance between healthy competition and maintaining stringent regulatory standards is essential to ensure the competence and professionalism of IPs while upholding the credibility and robustness of the insolvency regulatory framework. Competition among IPAs plays a vital role in elevating the competence and performance of IPs in the insolvency ecosystem. Each IPA's quest to attract members through its resources, support, and professional development opportunities fosters a culture of continuous learning and growth within the profession. As IPs compete for recognition and success in this landscape, they would be motivated to enhance their expertise, skills, and adherence to ethical standards. This competition-based model creates a positive feedback loop, elevating the overall effectiveness and reputation of the insolvency regulatory framework in India.

PRESENT POSITION

As recommended by the BLRC, the insolvency profession follows a two-tier regulatory structure, with the IBBI serving as the principal regulator and three IPAs as frontline regulators. IBBI has the authority to promote the development, regulate the practices, and monitor the performance of IPAs. IPAs are registered with and overseen by the IBBI. To become an IPA, a company registered under section 8 of the Companies Act, 2013 must have a minimum net worth of ₹ 10 crore and must meet certain other requirements.[2]

IPAs are required to establish various committees to regulate and oversee their professional members, including Membership Committees, Monitoring Committees, Grievance Redressal Committees, and Disciplinary Committees.[3] IPAs are responsible for monitoring the conduct and performance of their members and taking appropriate action against those IPs who do not comply with the provisions of the Code/ regulations or their bye-laws. According to IBBI regulations, an IP must hold authorisation for assignment (AFA) from the respective IPA while accepting any assignment under the Code.[4] IPAs also conduct pre-registration educational courses, continuous professional education, and professional development activities such as webinars, workshops, and seminars for their members.[5]

REGULATORY FRAMEWORK

A self-regulated organization (SRO) is a professional body that assumes the responsibility of establishing and enforcing rules and standards for its members while simultaneously safeguarding the public interest. This concept implies that the state abandons its role of hierarchical control and aims instead to influence the processes at work in society.[6] Thus, IPAs as SROs can be expected to establish and enforce robust ethical standards, prioritize continuous professional development, and implement effective monitoring mechanisms for compliance and thus effectively embody the principles of self-regulation in the insolvency ecosystem. IBBI serves as the independent regulator entrusted with the oversight and regulation of the insolvency ecosystem, including IPAs and IPs. In the best scenario envisioned for the regulated self-regulation approach in the Indian insolvency ecosystem, IPAs would take on the primary responsibility of regulating and overseeing the conduct of IPs. This division of roles would create a harmonious regulatory environment, with IPAs driving the day-to-day regulation and the IBBI acting as a vigilant overseer.

The evidence suggests that IPAs have been performing traditionally well in their developmental roles, focusing on capacity building, training programs, and continuous professional development for their members. However, disciplinary role of IPAs is yet to see significant outcomes. This is further substantiated with the fact that most stakeholders channel their complaints or grievances against an IP to the Board rather than the respective IPA, and the IPAs, viz. ICSI IIP, IPA ICAI and IIIP ICAI which have received only 83, 35 & 283 grievances from stakeholders since inception as against 6812 grievances/complaints received by the Board. On the number of disciplinary orders, the number disposed by IPAs, may seem reasonable at 163 as compared to 206 by the IBBI, however, on closer examination one can see through the nature of contraventions or the outcome of these orders which majorly deal with non-filing of forms and disclosures and it becomes clear that action on serious violations are almost exclusively being dealt by IBBI.

POSSIBLE CONCERNS

Stakeholders, including creditors, investors, and debtors, could face uncertainty and decreased confidence in the insolvency process due to the potential inconsistencies in regulatory standards across different IPAs. Disparities in qualifications, conduct, and disciplinary actions of IPs could lead to varying levels of professionalism and ethical conduct, affecting the quality and reliability of insolvency proceedings. The regulated self-regulation approach adopted in the Indian insolvency ecosystem might raise several concerns due to its design, that warrant careful consideration and proactive measures to mitigate them. These concerns encompass various aspects and potential challenges associated with the hybrid regulatory framework, including:

(a) Regulator competing for taking regulated in its fold

The self-regulated approach entails competition among self-regulatory bodies.[7] The design presents a paradoxical situation, where regulators (IPAs) compete for enrolling the regulated (IPs) to their respective folds. While competition can foster efficiency and innovation in the profession, it also raises concerns about potential compromises on regulatory standards and the emergence of conflicts of interest amongst IPAs. The front-line regulators, in their pursuit of acquiring the professionals, may lower qualification requirements for enrolment or relax oversight mechanisms to appear more attractive, leading to a 'race to the bottom' approach. The competition for a larger market share of IPs might divert their focus from upholding uniform standards or towards securing a healthy competitive edge. Industry initiated self-regulatory schemes are more likely to be effective when the interests of the industry and the community more generally coincide.[8] Consequently, this could undermine the overall integrity and effectiveness of the insolvency regulatory system. Thus, addressing these potential conflicts of interest requires a nuanced equilibrium between fostering healthy competition and at the same time upholding unwavering standards of professionalism amongst IPAs.

(b) Regulatory arbitrage

The presence of multiple IPAs poses a risk of regulatory arbitrage, where a professional may seek to register with the IPA or shift to an IPA that offers the most lenient regulatory framework, enabling them to circumvent stricter regulations and oversight enforced by other IPAs. This could lead to inconsistencies in the application of regulatory standards, eroding the uniformity and effectiveness of the insolvency regulation system with varying levels of regulatory scrutiny and enforcement.

(c) Issue of double jeopardy

Under the hybrid regulatory framework, professionals may face the risk of being subjected to disciplinary actions by both the IPA and the IBBI for the same act of misconduct. This duplication of disciplinary proceedings may be seen as an unfair burden by professionals and may also potentially lead to conflicting or dissimilar outcomes.

(d) Dual burden on professionals

IPs find themselves obligated to report and comply with requirements set forth by both the IPA and the IBBI. For instance, IPs may need to provide separate information, declarations, or disclosures to both IPA and the IBBI, leading to inefficiencies in time and resources. Additionally, differing reporting formats or criteria across IPA and the Board further exacerbate the dual burden, as IPs may need to adapt their reporting to meet the specific requirements of each regulatory body.

(e) Jurisdictional issues between IBBI and IPA

The hybrid regulatory approach, with IBBI and IPAs have overlapping roles may give rise to jurisdictional issues and conflicts and may lead to confusion and uncertainty. This may create challenges for IPs and other stakeholders and might also lead to a situation where an issue remains unattended on the assumption that other authority is supervising it.

Recently the IBBI has allowed the Insolvency Professional Entities (IPEs) to enrol as IPs in terms of regulation 6(1A) of IBBI (Insolvency Professionals) Regulations, 2016 (IP Regulations).[9] These IPEs will need to enrol with an IPA and register with IBBI like any natural person. While disposing the functions under an assignment, the IPE need to be represented by an authorised signatory who would be an IP.[10] It is reasonable to expect on behalf of an IPE that for non-systematic issues, the particular IP should be responsible for his actions or omissions. However, it presents a possibility that the IP may be a member of an IPA which is different from that whose member is the IPE. Which IPA would regulate such actions will need to be specified and would need to be augmented with suitable reporting requirements.

MITIGATING FACTORS

While the design choice suggests some potential concerns, the present framework also has some factors which mitigate these concerns. Some of the mitigating factors are as follows:

a) Model Bye-laws

IPAs carry their regulatory function based on bye-laws, which have to comply[11] with the standards provided by the Board, under the IBBI (Model Bye Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016 (IPA Regulations). These Model bye-laws provide a common framework for the functioning and regulation of IPAs. By incorporating the Model bye-laws into their organizational structure,[12] IPAs are required to keep a cohesive approach to regulatory practices, mitigating the risk of regulatory arbitrage. Further, to prevent conflicts of interest and ensure adherence to the broader objectives of the insolvency regulatory framework, any amendment to the bye-laws requires prior approval from the Board.[13] It even goes to the extent that any amendment to the bye-laws will be applicable only after seven days. Therefore, the approval process acts as a safeguard against dilution of regulatory standards, aligning any changes made to the bye-laws with the Board's objectives and policy directions, thereby maintaining the functional synchronization.

b) Portability for IPs amongst IPAs

To encourage healthy competition, allowing portability for IPs amongst IPAs is an effective mitigating measure. Regulation 7(2)(e)[14] of IP Regulations permit portability which enables IPs to move between different IPAs while retaining their registration and credentials. It creates a dynamic environment where IPs can choose the IPA that best aligns with their professional goals and values, while still adhering to the regulatory framework established by the Board. Portability also fosters flexibility, efficiency, and a conducive ecosystem for the insolvency profession. When utilized constructively, portability can perpetuate a consistent trajectory of professional excellence within IPAs, rather than merely functioning as an isolated strategy to attract professionals.

c) Common IT platform

The Board issued a Circular[15] for filing of forms by an IP in the electronic portal enabled by the Board for monitoring corporate insolvency resolution processes (CIRPs) which encapsulates and covers various periods in a CIRP as per timeline. The IPAs have been granted access to the same for monitoring purposes and it also lessens the compliance burden on IPs. The common IT platform allows for timely identification and resolution of any non-compliance issues, and also reduces the chances of IPs evading regulatory oversight through agency change. Further, as reported in Quarterly Newsletter for January-March, 2023 by IBBI, the integration of IT platforms of IPAs as well as other stakeholders such as Information Utility and National Company Law Tribunal with the IBBI is under contemplation.[16]

d) Common exam and syllabus

To ensure a benchmark of competence and expertise among IPs, there exists a common exam (Limited Insolvency Examination) and with a common syllabus for qualification in terms of regulation 3[17] of IP Regulations. It tests the knowledge and application of knowledge of individuals in the areas of insolvency, bankruptcy and allied subjects. This measure standardizes the assessment process, ensuring that all IPs meet a consistent level of proficiency. A unified qualification prevents discrepancies in IP qualifications across different IPAs and mitigates any chances of arbitrage on this aspect.

e) Uniformity of PREC among IPAs

Regulation 5(b)[18] of IP Regulations mandate the completion of the Pre-Registration Educational Course (PREC) from an IPA to strengthen the capacity and knowledge of IPs, thus imparting requisite skills and knowledge to handle complex insolvency cases effectively. The Board has developed and prescribed a comprehensive and standardized curriculum for the PREC,[19] covering essential subjects and practical training. Notably, an IP is not bound to obtain the PREC from his IPA. Coupled with this freedom and uniformity in the PREC structure mitigates any possibility of arbitrage.

f) Regular meetings with IPAs

Maintaining open communication and regular meetings between the IBBI and IPAs is vital to address concerns and enhance the regulatory framework's effectiveness. Periodic monthly meetings are held to facilitate discussions on challenges, progress, and best practices, enabling mutual learning and collaborative problem-solving.[20] These interactions also provide an opportunity for IPAs to share their experiences and insights, enabling the Board to gain a better understanding of the industry's dynamics and identify areas that require improvement. These regular interactions ensure that the functions of the IPAs are carried out in accordance with the bye-laws and the underlying intent.

INTERNATIONAL POSITION

The Indian concerns surrounding the hybrid regulatory framework, notably the conflict of interest and potential inconsistencies, find resonance in the experiences of other jurisdictions, shedding light on their potential impact and providing valuable insights. A brief scan of the insolvency regulatory frameworks in other jurisdictions provides valuable insights into the issues that may affect the effectiveness of the regulated self-regulation approach adopted in India is as follows:

a) United Kingdom: Insolvency Service and Recognized Professional Bodies

In the United Kingdom, the regulation of Insolvency Practitioners (IPs) is carried out by recognized professional bodies (RPBs), which are authorized and monitored by the Insolvency Service, an executive agency of the UK government.[21] Some key RPBs include:

- The Insolvency Practitioners Association (IPA)
- The Institute of Chartered Accountants in England and Wales (ICAEW)
- The Association of Chartered Certified Accountants (ACCA)
- The Chartered Institute of Management Accountants (CIMA)

The UK's insolvency regulatory framework shares some similarities with India's approach, as both involve multiple regulatory bodies (RPBs/IPAs) responsible for registering and regulating UK IPs under the supervision of a central regulatory authority (the Insolvency Service in the UK / IBBI in India). Some of these responsibilities are:

- **Licensing and authorizing qualified IPs**: Before being authorized to act as an IP, individuals must satisfy stringent criteria set out by the RPBs. This often includes successfully completing specific examinations, gaining practical experience under the guidance of an experienced IP, and demonstrating an understanding of the ethical and professional standards set by the RPBs.[22]

- **Setting professional standards, ethics, and best practices for IPs**: RPBs frequently develop and disseminate best practices and professional standards, which IPs are required to follow. The UK's Insolvency Service also issues Statements of Insolvency Practice (SIPs),[23] which provide guidelines for insolvency practitioners. The Insolvency Rules also prescribe specific requirements and procedures. These not only cover technical knowledge but also emphasize ethical considerations, professional judgment, and behaviour. For instance, the ICAEW provides a series of 'Insolvency Guidance Papers' that set out the expected behaviours and practices of their members when handling insolvency cases.[24]

- **Monitoring the performance and conduct of IPs**: Taking disciplinary actions against IPs, if necessary, in cases of misconduct or non-compliance.[25] In the process of overseeing IP's performance and conduct and taking disciplinary actions when necessary, a comprehensive list of factors is considered. These factors, both aggravating and mitigating, include considerations such as the impact on public interest, reputation, the nature of the conduct, financial implications, history of compliance, and the degree of responsibility which is similar to how disciplinary actions are initiated against IPs in India.

b) United States: United States Trustee Program (USTP)

In the United States, the insolvency and bankruptcy system is primarily overseen by the United States Trustee Program (USTP), a component of the Department of Justice.[26] The USTP's key functions include:

- Appointing and supervising private trustees who manage bankruptcy cases under Chapters 7, 11, 12, and 13 of the United States Bankruptcy Code.[27]

- Ensuring the integrity of the bankruptcy system by monitoring the conduct of parties involved, including debtors, creditors, and attorneys.

- Taking enforcement actions against fraud, misconduct, and other abuses in the bankruptcy system.

- Providing administrative support for bankruptcy cases and monitoring the progress of the case.

USTP is a government entity, and its role in supervising private trustees and ensuring the proper functioning of the bankruptcy system broadly includes the functions carried out by both IPAs and IBBI. The USTP provides a more centralized regulatory approach compared to the hybrid model in India. The USTP, operates the Integrated Data Retrieval System - a centralized database that provides access to case information for bankruptcy professionals and the public. Trustees, before their appointment, undergo rigorous training and must satisfy certain qualifications, including demonstrating expertise in the bankruptcy field.[28] The USTP monitors a wide range of stakeholders within the bankruptcy system. They have a dedicated Office of Oversight within the Executive Office for United States Trustees for this purpose.[29] This proactive oversight ensures that all participants, from debtors to attorneys, operate with integrity. The USTP sets forth standards that bankruptcy professionals must adhere to. For instance, attorneys representing bankruptcy clients must disclose compensation arrangements and cannot charge excessive fees.[30] This promotes transparent and ethical conduct in the system.

c) Other Jurisdictions

In Australia, the Australian Securities and Investments Commission (ASIC) is responsible for regulating the corporate insolvency market, while the Australian Financial Security Authority (AFSA) oversees personal insolvency.[31] Registered liquidators and bankruptcy trustees in Australia are subject to regulation by these authorities,[32] ensuring that they adhere to professional standards and legislative requirements. AFSA operates the 'Bankruptcy Register', providing public access to bankruptcy records. Australia has regulations that govern insolvency practitioners' licensing and conduct, and these regulations are regularly reviewed and updated by the ASIC.

In Canada, the Office of the Superintendent of Bankruptcy (OSB) is a federal agency responsible for supervising the administration of the bankruptcy and insolvency system.[33] Licensed Insolvency Trustees (LITs) are regulated by the OSB, ensuring that they meet the professional standards and comply with the relevant legislation.

POSITION IN INDIA IN OTHER REGULATORY SPACES

A parallel of the arrangement above can be seen in the Indian securities market. In India, the SEBI is the primary regulatory authority for the securities market, responsible for protecting investors and ensuring the development and regulation of the market. Also, the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) play pivotal roles in the Indian securities market, enforcing competency standards and a code of conduct among various market participants. Both exchanges emphasize on education as well as protection. NSE and BSE offer resources and initiatives to educate market players. Further, the Investor Services Cell (ISC) in NSE caters to the needs of investors by resolving the queries of investors, resolution of investor complaints and by providing arbitration mechanism for quasi-judicial settlement of disputes. At each of the above ISC Centre, Exchange has constituted Grievance Redressal Committee (GRC)[34] with provisions for taking suitable and appropriate disciplinary actions.[35] Similar arrangements exist in BSE under the Department of Investors Services (DIS).[36] SEBI's overarching authority and guidance help ensure that NSE/BSE' regulatory measures align with the broader regulatory objectives of the securities market.

SUGGESTIONS FOR IMPROVEMENT

a) Activation of IPAs on disciplinary role under Board oversight:

To bolster the effectiveness of the insolvency regulatory framework, it is crucial to actively trigger IPAs in their disciplinary role while maintaining appropriate oversight by the Board. IPAs must play a proactive part in monitoring the conduct and performance of their registered IPs. Simultaneously, the Board's oversight must ensure that IPA carry out their disciplinary functions diligently and impartially, upholding the principles of fairness and transparency throughout the disciplinary process.

Data through system analysis can be strategically assigned to IPAs which may include comprehensive information such as CIRP forms, mandatory disclosures, progress reports of ongoing cases, instances of assignment without appropriate AFA, delays in processes, and continuing professional education (CPE) attainment records etc. IPAs may be tasked and monitored to take appropriate action on the basis of collection and analysis of such data sets. Further, a system of peer review could also be implemented to ensure unbiased scrutiny of professional conduct and adherence to regulations.

b) Robust Inspection policy:

A key aspect of enhancing the regulatory mechanism is the implementation of a robust inspection policy that leaves no room for discretion. The inspection process should be objective, standardized, and based on predetermined criteria to ensure fair and equal treatment for all IPs. No IP or IPA should be able to manipulate their behaviour to avoid being selected for inspection. The policy should account for factors such as portability amongst IPAs by IPs and eliminate any shadow zones where IPs could potentially evade scrutiny or escape accountability.

c) Role of the independent directors:

The IPA Regulations[37] provide that an independent director on the Governing Board of the IPA shall be nominated by the Board from amongst the list of names proposed by the IPA. Defining the role and responsibilities of the independent directors in IPA's Board[38] is essential to establish a clear and effective working relationship between the Board and IPAs. They should act as a liaison between the two entities, facilitating regular interaction and exchange of information.

SEBI and NSE/BSE have similar provisions for independent directors which are called as 'public interest directors'[39] under the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations), 2018. The suggested director is approved by SEBI similar to that of nomination by IPA and approval by IBBI. Under Schedule II of the Regulations, a 'Code of Conduct' for public interest directors has been laid out which states that they shall meet separately, at least once in six months to exchange views on critical issues. The public interest directors shall identify important issues which may involve conflict of interest for the stock exchange/ clearing corporation or may have significant impact on the functioning of recognised stock exchange and reported the same to the Board. Further, public interest directors shall have regular oversight on observations of Board's inspection particularly on issues of governance standards, technology and cyber security etc. Similarly, the Insurance Regulatory and Development Authority of India (IRDAI) under its 'Guidelines for Corporate Governance for insurers in India'[40] under Pt. 13 states that: '*... the independent directors shall meet at least once in a year to evaluate the performance of other than independent Directors. Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.'*

Thus, in a similar fashion, annual meetings may be held exclusively with the independent directors to discuss regulatory activities and challenges, with the independent directors assessing the IPA's performance in fulfilling its duties, towards disciplinary actions and implementation of regulatory measures. Additionally, interactions with the nominated members should be mandatory for inspecting authorities during inspections and investigations of IPAs by IBBI.

d) Seamless sharing of inspection data and addressing dual jeopardy:

Having a structured mechanism for seamless sharing of inspection and investigation data between IPAs and the Board can facilitate transparent and collaborative regulation. IPAs should provide the Board with their inspection and investigation outcomes. This data exchange may enhance the Board's ability to identify challenges and implement necessary improvements. With the seamless exchange of information and well-defined structure for respective roles between IPAs and IBBI, the concern of double jeopardy can be effectively mitigated.

e) Dissemination of IPs' profiles and data on IPAs' performance:

Transparency and accountability are pivotal in building public trust in the insolvency regime. To achieve this, the dissemination of information related to IPs' profiles and IPAs' performance on their various roles is imperative. This includes sharing data on processes, outcomes including costs, disclosures, disciplinary actions taken against IPs and CPE hours completed by IPs. By making this information publicly available, stakeholders can assess the professional standing of IPs and the efficacy of IPAs in fulfilling their regulatory responsibilities. Transparency not only fosters confidence but also incentivizes IPs and IPAs to maintain the highest standards of conduct and performance.

f) Enhancing coordination and cooperation between IBBI and IPAs:

Regular communication, coordination, and cooperation between the IBBI and IPAs are essential to minimize jurisdictional conflicts and ensure a seamless regulatory environment. Establishing mechanisms such as joint working groups, periodic meetings, and information sharing platforms can facilitate collaboration and promote a harmonious relationship. This coordinated approach would help in addressing jurisdictional issues, streamlining processes, and maintaining consistency in the regulation and oversight of IPs. Enhancing coordination and cooperation between IBBI and IPAs serves as a strategic response to the concerns surrounding conflicts of interest amongst IPAs while addressing regulatory inconsistencies and enhancing regulatory effectiveness.

g) Review of bye-laws:

In addition to overseeing the registration and functioning of IPAs, the IBBI may also review the bye-laws of IPAs from time to time. This review process ensures that the bylaws of IPAs remain relevant, aligned with the evolving regulatory landscape, and effectively address the challenges and concerns in the insolvency profession.

CONCLUSION

The regulated self-regulation approach adopted in the Indian insolvency ecosystem, which combines the roles of the IBBI and IPAs, presents a unique and potentially effective solution to the challenges faced in the insolvency and bankruptcy sector. This approach leverages the expertise and knowledge of IPAs while providing oversight and guidance from the independent regulator, the IBBI. However, it is essential to address the concerns that arise from this approach to ensure the effectiveness and credibility of the insolvency regime.

The concerns outlined in this paper, including competition between IPAs, regulatory arbitrage, jurisdictional issues, and the risk of double jeopardy, highlight the potential pitfalls that could undermine the integrity and functioning of the insolvency framework. These concerns can have detrimental effects on the insolvency regime's ability to protect the interests of stakeholders and uphold the principles of fairness and transparency. By strengthening the mitigating factors, the institutional structure of IBC ecosystem will be more robust to meet the potential challenges and credibility of the regulatory system will be maintained at a higher level.

[1] The Report of the Bankruptcy Law Reforms Committee, November, 2015.

[2] Regulation 3(1)(c) of the IBBI (Insolvency Professional Agencies) Regulations, 2016.

[3] Clause 8 of the Schedule under the IBBI (Model Bye Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016).

[4] Regulation 7(A) of the IBBI (Insolvency Professional Agencies) Regulations, 2016 and Clause 12(A)(1) of Schedule under the IBBI (Model Bye Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016.

[5] Regulation 5(b) of the IBBI (Insolvency Professionals) Regulations, 2016.

[6] Thompson V. (1961), “Hierarchy, Specialization, and Organizational Conflict”, Administrative Science Quarterly 5, No. 4, p. 485–521.

[7] Ségolène Barbou des Places (2006), “Self Regulation and The Professions: A Perspective from Regulatory Competition Theory”, Kluwer International Law.

[8] Hepburn G., Report by OECD on “Alternatives to Traditional Regulation”.

[9] Regulation 6(1A) of the IBBI (Insolvency Professionals) Regulations, 2016.

[10] Regulation 7(ha) of the IBBI (Insolvency Professionals) Regulations, 2016.

[11] Regulation 5(2)(a) of the IBBI (Insolvency Professional Agencies) Regulations, 2016.

[12] Regulation 3 of the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016.

[13] Regulation 4 of the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016.

[14] Regulation 7(2)(e) of the IBBI (Insolvency Professionals) Regulations, 2016.

[15] Circular No. IBBI/CIRP/023/2019 issued on 14th August, 2019.

[16] “Digitalisation of IBC” from Chairperson’s Desk, IBBI Quarterly Newsletter, January-March, 2023.

[17] Regulation 3 of the IBBI (Insolvency Professionals) Regulations, 2016.

[18] Regulation 5(b) of the IBBI (Insolvency Professionals) Regulations, 2016.

[19] Circular No. Circular No. IPA/011/2018 on ‘Pre-registration educational course under regulation 5(b) of the IBBI (Insolvency Professionals) Regulations, 2016’ issued dated 23rd April, 2018.

[20] IBBI, Annual Report 2020-21.

[21] The Insolvency Service, (2023), “How We Regulate Insolvency Practitioner”.

[22] Conway L. (2023), “Regulation of Insolvency Practitioners (IPs)”, 15th February.

[23] The Insolvency Service (2014), “Statements of Insolvency Practice: for insolvency practitioners”.

[24] ICAEW (2023), “Insolvency guidance papers”.

[25] Chartered Accountants Ireland (2013), “Guidance in relation to disciplinary sanctions and orders”.

[26] United States Department of Justice, United States Trustee Program, ‘About the Program’.

[27] US Bankruptcy Code, 11 USC §§ 701-784 (Chapter 7), 1101-1174 (Chapter 11), 1201-1231 (Chapter 12), 1301-1330 (Chapter 13).

[28] United States Trustee Program.

[29] United States Department of Justice, United States Trustee Program, Office of Oversight.

[30] United States Department of Justice, United States Trustee Program, 'Retention and Compensation of Professionals in Bankruptcy'.

[31] Australian Securities and Investments Commission, 'Insolvency' (ASIC) & Australian Financial Security Authority, 'Bankruptcy' (AFSA).

[32] RG 258.12 of the Insolvency Law Reform Act 2016.

[33] Government of Canada, Office of the Superintendent of Bankruptcy Canada, 'About the Office of the Superintendent of Bankruptcy'.

[34] National Stock Exchange of India Limited, Grievance Redressal Committee.

[35] National Stock Exchange of India Limited, NSE Rules.

[36] Bombay Stock Exchange, "Complaint against Trading Members".

[37] Regulation 5(7) of the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016.

[38] Regulation 5(7) of the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016.

39 Regulation 2(o) of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations), 2018.

[40] IRDAI (2016), "Corporate Governance Guidelines for Insurers in India, 2016", 18th May.

11

Fostering Excellence in the Insolvency Profession – Need for Insolvency Practice Standards

- Archana Sharma and Anchita Sood

'Within the intricate landscape of insolvency, professional standards stand as the fortresses of ethics and skill, safeguarding the financial renaissance of both individuals and economies.'

- John Kenneth Galbraith

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) bestows paramount importance to the role of an Insolvency Professional (IP), which serves as a key institution in the Indian insolvency regime. The IP assumes a significant position in the resolution, liquidation, and bankruptcy processes of a wide range of entities such as companies, limited liability partnerships, partnership firms, proprietorship firms, and individuals.

Within a span of 7 years, the IBC has created an ecosystem of more than 4200 IPs. The contribution of the insolvency profession is reflected in the volume of the processes handled, value of resolutions achieved, behavioural change cultivated in the system, and many more nuanced developments in the IBC landscape. Till March 31, 2023, the IPs have handled 6571 corporate insolvency resolution processes (CIRPs) and 2030 liquidation processes. Out of these, 678 CIRPs have yielded resolution amounting to realisation to creditors to the tune of ₹2.86 lakh crore.[1] The highest number of resolution plans i.e., 180 were approved in financial year 2022-23.

The insolvency profession has embraced dynamism of the evolving economic and legal framework with agility, resilience, and innovation. In the wake of the COVID-19 pandemic, the IPs responded in time and demonstrated professional dexterity with the adoption to newer norms into their practice like virtual meetings, remote work setups, increased utilisation of digital tools, virtual data rooms, online filings, pleadings and many more.

The IBC has exhibited promising results so far. The Government is proactively exploring the potential areas for enhancing the robustness of the IBC framework. In some areas like cross-border insolvency, group insolvency, extensive groundwork has been done, while the other areas like mediation, technological adoption through integrated case management system, are still under active deliberations. These reforms might see the light of the day in the times ahead. It is thus imperative to strengthen and develop the existing implementation mechanisms and enable seamless adoption of the new reforms.

The IPs are the key facilitators for operationalising the law. IPs should be adequately equipped to embrace the changes and aid in smooth implementation. To this end, there is a need to build capacity of IPs and improve the efficiency and effectiveness of their practice. This article underscores the need for formulating Insolvency Practice Standards (IPS) in the Indian insolvency framework to build capacity and bring clarity, consistency, and transparency in the insolvency practice.

REGULATORY ARCHITECTURE IN INDIA

The IBC framework provides for a two-tier regulatory architecture, wherein the Insolvency and Bankruptcy Board of India (IBBI/Board) is established as the principal regulator and Insolvency Professional Agencies (IPAs/Agencies) are established as the front-line regulators. The IBBI is the regulator of the profession and the processes. IPAs are predominantly entrusted to set minimum standards of behaviour expected from all IPs and specify bye-laws governing specific areas of IP's conduct. IPAs are responsible for the ongoing professional development of IPs, ensuring that they are conversant with the evolving jurisprudence and best practices.[2]

The regulatory scheme ensures that only qualified and competent individuals are entrusted with the responsibility of serving as IPs in insolvency proceedings. The Code establishes a high level of professionalism and knowledge by providing four stage process to become an IP i.e., passing the examination, enrolling with an IPA, undergoing pre-registration educational course and finally registering as an IP with IBBI.

By establishing eligibility criteria that prioritize relevant experience and qualifications and implementing a comprehensive fit and proper test,[3] the regulations ensure that only capable and trustworthy individuals are registered as IPs. The regulations notably include a code of conduct for IPs, encapsulating areas like- integrity and objectivity; independence and impartiality; professional competence; representation of correct facts and correcting misapprehensions; timeliness; information management; confidentiality; occupation, employability and restrictions; remuneration and costs and gifts and hospitality. IPs are required to ensure continuous professional education and practice only after obtaining the authorisation for assignment (AFA) from the IPA.

The IBBI and IPAs also undertake disciplinary actions, thereby reinforcing the accountability and credibility of the insolvency profession.

ROLE OF IPs

The Bankruptcy Law Reforms Committee (BLRC), which conceptualised the Code, emphasised the indispensable role of IPs and underlined their critical functions. It advocated that the IPs serve as a crucial pillar in the effective, timely, and credible functioning of the insolvency and bankruptcy resolution process. Their knowledge and commitment serve as the foundation of this system, ensuring that all parties are treated equitably and that the insolvency procedures are carried out seamlessly and transparently.[4]

The IP is the key player in the insolvency procedures and serves as a crucial facilitator between the Adjudicating Authority (AA) and all of the stakeholders. These stakeholders encompass the debtor, creditors including financial creditors (FCs) and operational creditors (OCs), as well as the resolution applicants (RAs). IP's duties involve engagement and execution at the closest level of operations, be it with the debtor, creditor or the AA. They act as primary source of information in the process. Given this indispensable role, an IP is expected to demonstrate adherence to code of conduct in letter and spirit.

CONTOURS OF THE EXISTING FRAMEWORK OF PROFESSIONAL STANDARDS

The existing framework has substantive provisions to take measures to build capacity and develop the profession. The law empowers the IPAs to form an Advisory Committee of its professional members to advise on matters pertaining to development of the profession, standards of professional and ethical conduct and best practices in respect of insolvency resolution, liquidation and bankruptcy. The IPAs have formulated, published or recommended a few statements of best practices in the limited areas like meetings of committee of creditors (CoC), CoC's role in CIRP, role of IPs in avoidance proceedings, individual insolvency under IBC, 2016 (with reference to personal guarantor to corporate debtor). [5]

Additionally, a few publications and reports have also been issued to cater to crucial issues in areas like Role of IPs/ Professionals across insolvency value-chain from incipient stage till post-resolution stage, Avoidance Transactions under IBC 2016 – Improving Outcomes, Background Guidance on Valuation Process under IBC, 2016, Background Guidance on Code of Ethics for Insolvency Professionals, Background Guidance on Quality Control by Insolvency Professionals, Enhancing Role of Small Sized Insolvency Professionals in Insolvency Resolution Ecosystem, etc.

The Board has also issued facilitation documents to aid the IPs in performing their duties like handling CIRP, liquidation process, Role of IP in Avoidance Transactions, Avoidance Transactions - Red Flag Document, Role of the Government and its Agencies in the Corporate Insolvency Resolution and Liquidation Processes, Mistakes Committed by IPs, etc. [6]

However, the available repository on statement of best practices formulated so far is quite limited, highlighting the necessity for a broader scope and continuous improvement.

The Standing Committee on Finance has highlighted that there are numerous conduct issues with regard to Resolution Professionals (RPs) for which the regulators have taken disciplinary actions on 61% IPs against whom inspections were conducted. [7] While the Board has taken corrective measures to address this issue, a uniform approach in undertaking assignments can help reduce possibility of deviations by the IPs. [8]

The Standing Committee had also recommended to establish a single regulator on the lines of the Institute of Chartered Accountants of India (ICAI) as an Institute of Resolution Professionals to ensure that there are appropriate standards and fair self-regulation. While the establishment of a single regulator needs extensive deliberations, a uniform set of standards can serve the purpose of bringing in uniformity in the conduct of processes by the IPs, irrespective of the IPA they are enrolled with as a professional member.

THE CASE FOR INSOLVENCY PRACTICE STANDARDS

Having overcome the initial impediments in its infancy, the profession is now poised to take a progressive stride forward by converging to a uniform approach through insolvency practice standards.

An IP assumes various roles or undertakes multiple assignments for a debtor. Like, IP can perform the role of an Interim Resolution Professional, RP, authorised representative in the CIRP of a corporate debtor (CD). Additionally, IP can perform the role of a Liquidator in the liquidation process of the same CD. It is pertinent to note that each role has its own distinctly defined duties and functions. Moreover, the nature of process i.e., CIRP or liquidation can also be different for a CD. Every debtor may have certain peculiarities as regards nature, size, geographical reach, litigations, industry-specific norms, and more. Consequently, the approach of conducting the process may differ between assignments and debtors. This array of diverse circumstances demands a standardized set of practice standards. These standards would offer guidance to IPs facing similar situations, promoting consistency in approach and ensuring uniformity.

In professional fields, standards refer to a set of established guidelines, norms, principles, procedures, and best practices that outline the recommended methods and steps for accomplishing tasks, projects, or services in a consistent and effective manner. These standards are designed to ensure quality, efficiency, consistency, and reliability in the delivery of products or services while adhering to industry-specific norms and professional requirements. They help professionals achieve uniformity, consistency, and excellence in their work, regardless of the nature of assignment involved.

While the code of conduct outlines the expected standards of behaviour, the professional standards outline the manner of practicing the law which best suits in a particular situation. The code of conduct serves as a guiding force by imposing moral responsibilities and delineating certain behaviours that individuals cannot freely choose to engage in according to their preferences and self-vested interests. The professional standards, on the other hand, provide guidance on performance through a consistent, uniform and systematic approach, irrespective of the wide-ranging scenarios. It is about demonstrating the code of conduct while practicing alongside the contours of practice standards.

The indisputable requirement for an effective, efficient, transparent, and predictable insolvency law has been underpinned in the foundational framework.

The UNCITRAL (United Nations Commission on International Trade Law) Legislative guide in its design of key objectives and structure of an effective and efficient insolvency law has emphasised that: *'Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business activities of the debtor and to minimizing the cost of the proceedings.'* It has further advocated that *'An insolvency law should be transparent and predictable. This will enable potential lenders and creditors to understand how insolvency proceedings operate and to assess the risk associated with their position as a creditor in the event of insolvency.'*[9]

While underscoring the importance of transparent and predictable insolvency law, it has highlighted the negative impact that it may have i.e., *'Unpredictable application of the insolvency law has the potential to undermine not only the confidence of all participants in insolvency proceedings, but also their willingness to make credit and other investment decisions prior to insolvency.'*

In a Report published by International Monetary Fund on 'Orderly and Effective Insolvency Procedures', it was pointed out that – *'Recent experience has demonstrated the extent to which the absence of orderly and effective insolvency procedures can exacerbate economic and financial crises.'*[10]

The IBC has established a robust insolvency law architecture. While it is acknowledged that the achievement of objectives of the Code does not entirely rest upon the IP, however, the legal framework can be augmented by a systemically developed framework of practice standards formulated in view of the experience gained, prevailing conditions and the potential reforms.

EXPANDING HORIZONS OF THE INDIAN INSOLVENCY ECOSYSTEM

The Indian insolvency law is embracing new frontiers with emerging areas like cross-border insolvency, group insolvency, mediation and more.

The Report of Colloquium on Functioning and Strengthening of the IBC ecosystem, has proposed three frontier areas as next generation reforms viz., application of mediation in corporate insolvency situation, a creditor-led resolution approach as an alternative to CIRP and cross-border insolvency.[11]

On the Mediation framework, the Report has recommended that *'it is the most opportune time to be ready for early roll-out of mediation process in the context of the Code'*.

It has also underscored the fact that *'as part of the roll-out strategy, a cadre of mediators may be trained simultaneously to assist the parties in negotiation and resolution of disputes in various stages, before and after admission of insolvency proceedings'*.

As regards, creditor-led resolution approach, the Report had recommended constitution of an Expert Committee for making recommendations for its early roll-out. The Expert Committee has recommended a new framework for 'out-of-court' initiated creditor-led insolvency resolution process and key legislative amendments.[12]

The Report of Colloquium has also underscored the need to adopt a cross-border insolvency framework on an urgent basis.

Earlier, the Report on the rules and regulations for cross-border insolvency resolution has made recommendations *'in respect of capacity building requirements at the NCLT and the IBBI to deal with cross-border matters.'* [13] It has recommended need for multi-dimensional capacity augmentation in terms of benches, physical and technological capacity, human capacity, standards of procedure, training, etc.

Similarly, the Report on Group Insolvency has also recommended that *'Effective capacity building measures and increase in use of technology during implementation will bolster the efficiency of the group insolvency framework'*.[14] For this, effective training, knowledge building measures, development of standards of procedure for treating applications related to groups may be beneficial.

The extensive deliberations, thrust for fast-tracking implementation of new frontier areas and ongoing developments make it clear that the implementation of these areas would expand the horizons of present insolvency framework. It would certainly involve more intricate, complex, and diverse processes demanding meticulous execution. Thus, systematically designed insolvency practice standards alongside the implementation of these areas would facilitate their smooth implementation.

In the meanwhile, the reinforcement of existing ecosystem with robust practices becomes imperative. The positive externalities of these developments would have spill-over effects in the new areas that may come up in the years to come.

INTEGRATION INTO THE DIGITAL ECOSYSTEM

The Report of Colloquium had recommended for an integrated technology platform for the insolvency ecosystem. It had proposed for development of a standardised template for an effective case management.

The Ministry of Corporate Affairs (MCA) in its consultation paper seeking comments on proposed changes to the Code had advocated the need for use of technology in the IBC ecosystem. [15]

The IBBI has also emphasised the need for digitalisation of IBC. It highlighted that the need for a comprehensive end-to-end technology solution would cover all the activities in the IBC ecosystem from debt and default filing to implementation of resolution plan. [16]

The Reports on cross-border insolvency and group insolvency have also recommended use of technology and need to bolster the technological infrastructure for smooth implementation of these reforms.

In the wake of these developments, it will be a step in the right direction to formulate insolvency practice standards and integrate them with the e-platform right from their conceptualisation and design.

THE RELATIVE COMPARATIVES

Every industry or profession caters to a diverse set of stakeholders and involves varied situations to be dealt with as per the applicable law. Thus, the practice of having a unified set of standards exists in majority of the industry segments and professions, be it in India or globally. These standards may be identified with different nomenclatures, be it, practice standards, professional standards, code of ethics, code of conduct, industry standards, technical standards, quality assurance standards, etc. While the context, scope and design may vary but the underlying objective is to ensure uniformity, transparency, and a benchmark performance from those who are required to follow or practice the law or profession. Hence, these standards are designed as a guiding principle to execute a task in any given situation taking into account the purpose, nature, complexity, timeline and other disparate factors.

Presently, the insolvency law deals primarily to the corporate segment and personal guarantors to these corporates. It is important to understand that the Indian corporate realm thrusts greatly on the standards in the various fields to ensure transparent and consistent reporting, safeguarding investor interests, and preventing abuse of power in any manner. The Companies Act, 2013 provides the framework for applicability of secretarial, accounting, auditing, and cost accounting standards.

The Central Government has the power to prescribe the standards of accounting or any addendum thereto. [17] The confirmation to adherence to applicable accounting standards is to be provided in the Directors' Responsibility Statement. [18] The auditor is mandated to examine the accounts and prepare the auditor's report in the accounting and auditing standards. [19] Similarly, while conducting the cost audit, the Cost

Accountant is required to comply with cost accounting standards. [20] The law even mandates a company to observe secretarial standards with respect to general and Board meetings. [21] Thus, every major process is governed by the standards. The global counterparts of these standards hold prominence in all major economies.

While the Companies Act, 2013 refers to the professional standards, there are various industry segments and other professions which follow similar practices in their respective domains. The Medical Council of India has set professional standards for medical professionals,[22] including ethical guidelines, code of conduct, and clinical practice norms including maintenance of medical records, and ensuring patient safety, surgical safety checklists, medical documentation standards, etc. Engineers and construction professionals adhere to standards for design, safety, and quality control. Manufacturing industries have process standards for quality control, production efficiency, and safety.

Even the practitioners in environmental science and management adhere to process standards for sustainable practices, environmental impact assessments, pollution control, etc. The Environmental Impact Assessment (EIA) Manual provides process standards in the form of a check list providing guidance notes thereby establishing a review process that may be used while examining projects.[23]

Thus, professional and process standards are essential in different practice domains to ensure consistent quality, efficiency, and compliance with industry and profession specific laws. Adhering to these standards not only improves the performance of practitioners but also builds trust among clients, customers, and stakeholders.

INTERNATIONAL JURISDICTIONS

In United Kingdom, the authorised insolvency practitioners are required to comply with Statements of Insolvency Practice (SIPs) issued by the Insolvency Service. SIPs are issued to insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency. The purpose of SIPs is to outline basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standards established in SIPs may be considered in the event of disciplinary or regulatory action. [24]

Similar service standards or guidelines for insolvency practitioner services exist in other major jurisdictions like USA, Australia, Canada, Finland, Hong Kong, Ireland, etc. [25]

EXPECTED OUTCOMES AND BENEFITS

The experience from other professions suggests that professional excellence extends beyond the mere entry into the profession. It entails a self-imposed discipline to embody the essence of the profession in both letter and spirit. While practice standards enable the professionals to carry out their functions seamlessly, the professionals are expected to demonstrate highest levels of ethical and professional standards while performing their duties.

Overall, the insolvency practice standards are expected to bring uniformity, consistency, and efficiency in the processes. This will result in multi-fold benefits to all the stakeholders involved. In light of fundamental prerequisite discussed above, the potential benefits of implementing insolvency practice standards have been discussed in ensuing paragraphs: -

(a) Standardization and consistency

As discussed *supra*, predictability in the insolvency procedures holds paramount importance for ensuring success of the process. Insolvency practice standards would ensure consistency and predictability in the processes. This would result in a unified approach of undertaking assignments. The standardisation would foster efficiency of the processes.

(b) Facilitating achievement of objectives of the Code

As enshrined in the preamble of the Code, the first order objective is resolution. The second order objective is maximisation of value of assets of the firm and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests of stakeholders. This order of objective is sacrosanct as held by Hon'ble NCLAT. [26] Timely resolution is also an ingrained feature of the Code.

As on March 31, 2023, the creditors have realised 168.47% of the liquidation value and more than 83% of the fair value. [27] In terms of realisation, the Code has outperformed other previous regimes. The recovery rate for the scheduled commercial banks through the Code was highest in financial year 2021-2022 compared to other channels such as Lok Adalats, The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 and Debt Recovery Tribunals. [28]

However, on an analysis of the time taken in completing processes under the Code, it is observed that as on March 31, 2023, 73% of ongoing CIRPs have exceeded timelines of 180 days stipulated under the Code and 55% of ongoing liquidations have exceeded timelines of two years. Thus, a sizeable number of ongoing cases have breached the prescribed timelines attributable to multiple factors and stakeholders.

The insolvency practice standards can serve as a catalyst in the entire process and would facilitate all the stakeholders in faster execution of the processes. It would bring in clarity, harmonisation and efficiency in the assignments. A structured and streamlined approach to insolvency processes would, therefore, aid in reducing delays, expediting the resolution process and facilitating value maximization.

(c) Facilitating judiciary and reducing litigations

The BLRC has underscored that 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 positive externality of better utilisation of judicial time. The worse the performance of IPs, the more the adjudicator may need to personally supervise the process, which in turn my cause inordinate delays.

The ingrained elements of clarity and consistency in the insolvency practice standards would help minimize litigations during the insolvency proceedings. The stakeholders will have a better understanding of the decision-making process of the IP in the conduct of the processes. This would aid in reduction of litigations at various levels. Moreover, the uniform approach would also assist in faster disposal, saving of costs, and resources for all parties involved.

(d) Capacity building

Adhering to the standards will provide guidance to the professionals in executing their assignments. The enhanced clarity would help IPs to direct their efforts towards the end goal of resolution, instead of expending energy on navigating through unpredictable paths. Consequently, this would help develop professional competence to handle case-specific peculiarities and complexities. The standards would serve as a guiding mentor for the novice professionals entering the ecosystem. This will reduce the learning curve and potential errors.

The quality of services rendered by IPs plays a pivotal role in building confidence of stakeholders in the insolvency ecosystem. [29] Overall, it would improve quality of services by IPs and would reduce instances of malpractice and fraud which would build consumer trust.

(e) Enhanced compliance standards

The IBBI and IPAs take action against recalcitrant IPs. With the increasing number of processes handled, the number of disciplinary actions has also increased. In the four years from financial year 2017-18 to 2021-22, the Board had issued 100 show cause notices, out of which 82 were disposed.[30] During financial year 2022-23, the disciplinary committee had disposed of 81 show cause notices against the service providers, the highest in any financial year so far. The insolvency practice standards would help reduce instances of contravention by IPs as there would a guidance on performing their duties and functions. However, any departure to the standards would also serve a guiding factor for the regulator to identify instances of contraventions by the IP.

(f) Creditor protection and avoiding abuse of the process

The Code aims to protect the interests of creditors by ensuring a fair and transparent resolution process. Insolvency practice standards will promote transparency, impartiality, and accountability**.** The established standards would act as a deterrent in making wilful departures to the laid down process. The standards will address the concerns of IPs for not getting cooperation from various stakeholders like debtor, creditor, etc. It can help reduce possibility of abuse of insolvency proceedings such as frivolous filings or attempts to delay the proceedings. Overall, this will preserve the integrity of the resolution process.

(g) Enhancing corporate governance

IP assumes an important role in upholding corporate governance principles in the operations of CD. Hon'ble Supreme Court in the matter of *Lalit Kumar Jain v. Union of India & Ors.* has also emphasised that the institutions and structures in the Code are aimed at promoting corporate governance.[31]

Thus, insolvency practice standards would provide a uniform, transparent and consistent approach in ensuring corporate governance.

(h) Facilitating implementation of new reforms

As discussed in the paragraphs *supra*, the insolvency practice standards would help in expeditious implementation of the new reforms as the practice and procedures would be laid down from the conceptualisation stage itself.

INDICATIVE APPROACH FOR DESIGN OF INSOLVECNY PRACTICE STANDARDS

To ensure wider acceptability and uniformity, the insolvency practice standards may be devised jointly by the IPAs with the approval of the Board.

The insolvency practice standards may lay down guidance on performing specific activities required under the law, manner of communication and documentation, wherever applicable, jurisprudence, and handling exceptions.

Keeping in mind the dynamism of the insolvency regime, the insolvency practice standards should allow adequate flexibility which may be done through continuous monitoring, feedback mechanisms, and periodic updates based on experience gained and jurisprudence evolved. The flexibility within standardized practices will ensure that IPs can address unique challenges while still adhering to core principles.

To start with, the insolvency practice standards may be formulated for the CIRP. The insolvency practice standards can be formulated for duties and functions required to be performed by the IPs right from the beginning of the process. This may include the process of giving consent, filing an application, attending hearings, making public announcements, collating claims, constituting CoC, conducting meetings of CoC, process of inviting and evaluating resolution plans, process of placing resolution plans before the CoC to filing application seeking approval of the AA. The list of activities goes on.

For every major function, a unified approach and guidance would save time of stakeholders, expedite the conduct of the process, facilitate AA in quick disposal of applications and would result in value maximization for the stakeholders.

CONCLUSION AND WAY FORWARD

In essence, IPs make a substantial contribution to the efficacy, legitimacy, and fairness of insolvency and bankruptcy resolution processes by adhering to the highest professional standards. The performance of an IP is also important due to the fact that it directly affects the economic interests of debtors, creditors and resolution applicants. Additionally, insolvency and bankruptcy processes have social ramifications.

Over a period of time, new professional opportunities would emerge for the IP, expanding the scope of their services. The insolvency practice standards would help in faster adoption of new role, smooth implementation of reforms and efficient conduct of process by the IPs.

The acceptability of insolvency practice standards by stakeholders other than IPs is also important in ensuring their successful implementation. Detailed research about the need and potential benefits of implementing insolvency practice standards may be undertaken to crystallise and implement these standards in a full-fledged manner.

[1] IBBI Quarterly Newsletter for January-March, 2023.

[2] The Report of the Bankruptcy Law Reforms Committee, "Volume I: Rationale and Design", November, 2015.

[3] Reg 4(1)(g), Insolvency And Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016.

[4] Supra Note 2.

[5] Resources, Publications, IIIPI website; Knowledge Centre, Statement of Best Practices, ICSI IIP website.

[6] Legal Framework, Facilitation, IBBI website.

[7] The Ministry of Corporate Affairs (2021), "Report of the Standing Committee on Finance on Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions", August, 2021.

[8] IBBI (Grievance and Complaint Handling Procedure) (Amendment) Regulations, 2022.

[9] UNCITRAL Legislative Guide on Insolvency Law, Part I and II, paras 8 and 11.

[10] Publications, Orderly and Effective Insolvency Procedures, IMF website.

[11] Report of Colloquium on Functioning and Strengthening of the IBC ecosystem, November, 2022.

[12] Report of the Expert Committee, "Creditor Led Resolution Approach", May, 2023.

[13] Report on the rules and regulations for cross-border insolvency resolution, June, 2020, p.8.

[14] Report of the Cross-Border Insolvency Rules/Regulations Committee (CBIRC-II) on Group Insolvency, December 2021, p.11.

[15] Ministry of Corporate Affairs, Notice – "Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016", January 18, 2023.

[16] Supra Note 1.

[17] Section 133, Companies Act, 2013.

[18] Section 134, Companies Act, 2013.

[19] Section 143, Companies Act, 2013.

[20] Section 148, Companies Act, 2013.

[21] Section 118, Companies Act, 2013.

[22] The Indian Medical Council Act, 1956 (Professional Conduct & Ethics) Regulations, 2002.

[23] EIA Manual, Ministry of Environment, Forest and Climate Change, Government of India, website.

[24] The Statement of Insolvency Practice, The Insolvency Service – UK website.

[25] IAIR - An international comparative study on the development of an insolvency profession and its performance, March 19, 2010.

[26] Binani Industries Limited v. Bank of Baroda & Anr., CA (AT) No. 82,123,188,216 & 234 -2018.

[27] Supra Note 1.

[28] Economic Survey, 2023.

[29] Supra Note 2.

[30] IBBI Annual Report, 2021-22.

[31] Transferred Case (Civil) No. 245/2020 and other writ petitions.

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Information Utility - A Vision for the Future

- Debajyoti Ray Chaudhuri

INTRODUCTION

The Information Utility (IU) is a unique Indian innovation. When the Code was notified, the IU had not started operations. It took some time for the IU to collect information regarding debtors and their credit history. With the support of Insolvency and Bankruptcy Board of India (IBBI) and other regulators like the Reserve Bank of India (RBI), the IU has now a substantial amount of data which has been submitted with the digital signatures of creditors and hence, of evidentiary value. The IU can facilitate resolution of debtors who are unable to repay their debts, using the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC/Code). While invoking the insolvency resolution process under the provisions of the IBC is an option, it is not necessarily the only way to achieve resolution under the IBC.

National E-Governance Services Limited (NeSL) is the first and only IU regulated by IBBI.

ROLE OF AN IU

The IBC and the regulations made thereunder, lay down the obligations of the IU and 'core services' (as defined in the IBC) to be provided by the IU. Consistent with these provisions, the IU has been constantly re-inventing itself in a rapidly changing environment of increased digitization. Within the larger objective of removal of information asymmetry, it's the endeavour of NeSL, as an IU, to provide the following services: -

a) Authenticated data and secure IT solutions for insolvency resolution under the provisions of the IBC.

b) Early warning system of incipient stress so that banks/financial institutions (FIs) can consider taking proactive steps for resolution of stressed debts, including but not necessarily limited to insolvency resolution under the provisions of IBC.

c) A platform for secure contract execution with digital e-signing, and e-stamping wherever required and be a repository of executed contracts including bank guarantees, with access to duly authorized persons.

Alerts by the IU- A tool in credit monitoring

The users of the IU like banks/FIs can access the information in the IU after a simple process of registration. However, the IU makes it much simpler for creditors- it provides a facility of notification by way of alerts, so that they can efficiently manage their credit process.

At the first instance, when default is reported to the IU, the IU does the process of authentication and verification of the information as provided in the IBBI (Information Utilities) Regulations, 2017. After that, a default broadcast is sent by email to all the registered users of the debtor. This removes information asymmetry, one of the objectives behind creation of the IU. It also ensures that even while default is only to one creditor, all creditors who are on the platform are alerted to the same. They can then initiate measures for risk mitigation like seeking additional cash or collateral from the debtor. If there are any undisbursed limits, creditor can take a view on taking further exposure to the debtor.

The second type of notification sent by the IU is when an application for initiation of insolvency is filed with the Adjudicating Authority (AA). This is specifically relevant when the application is filed by an operational creditor (OC) or a creditor which is not part of the consortium or the multiple banking arrangement. The other creditors like banks would not be aware of this till the application is admitted and a public announcement is made by the Insolvency Professional (IP) inviting submission of claims. However, IBBI has now made this data available to the IU by means of application programming interface and all the creditors of the debtor who are registered on the IU are notified of the same. The banks and other creditors thus became aware of the impending insolvency proceedings against their customer and can take an informed decision about the further course of action.

The third type of notification from the IU is when insolvency proceedings are initiated against a corporate debtor (CD) and a public announcement is made by an IP for creditors to submit their claims. Such a public announcement is made in a newspaper with wide circulation as provided in the IBC. However, there is a possibility that a creditor may miss out on such a public announcement and may not be able to submit his claims. However, if a creditor is registered as a user on the IU and has submitted financial information in respect of the CD, he will get a notification from the IU, that a public announcement has been made for submission of claims consequent to initiation of insolvency proceedings against the CD. The creditor can then not just submit his claims but also take other steps to protect his interests.

DIGITAL DOCUMENT EXECUTION - THE LAST MILE IN CREDIT DELIVERY

How it all began

When the IU started operations, it had provided a facility for upload of documents as evidence of debt, security and default. However, since debt documentation was done in physical form, uploading of documents proved to be a challenge, as the documents were voluminous, further the authenticity of the same could not be easily established. Moreover, issues of stamp duty jurisdiction meant that users were hesitant to upload such documents. NeSL's digital document execution (DDE) provides a platform where the debtor and the creditor jointly execute the document. Every document needs to be stamped under the provisions of the respective State Stamp Act. Accordingly, arrangements have been made with the various state governments for online and real time procurement of stamp duty. The stamp duty gets affixed with the document and the composite document is available for execution through digital signature. The platform supports three types of signatures like Aadhaar e-sign, digital signature certificate (DSC) and also Aadhaar based biometric authentication. The Aadhaar e-sign facility has ensured that the facility of digital signature has wider reach, as dongle-based DSC is in general not available to all.

Benefits to the ecosystem

DDE has enormous benefits by way of saving time and costs incurred in documentation. The document can be executed at the comfort of one's home or office at any time or day saving considerable time and expenses on actual travel for the purpose of execution of documents. The costs and risks entailed in storage of documents are eliminated and, being paperless, the process is environment friendly.

The country is increasingly going digital in many areas without the requirement of any physical documents. A driving license and PAN card can be accessed through Digi locker, Digi yatra ensures paperless entry into high security areas like airports with face recognition technology. Many of us would recall the harrowing experience in the earlier days, when, in the airport, after security check one is unable to locate one's boarding pass. Today one has to only secure one's mobile through which one can access everything whether it's a driving license or boarding pass and even a train ticket.

NeSL is a repository of authenticated documents which can be accessed by any of the parties who have executed the documents. A customer can immediately see the executed documents, he can access it at any time through the NeSL portal without any requirement for physical storage or even digital storage at his end. Banks and FIs which invest substantially in real estate and secure storage to ensure safe custody of security documents, can save on substantial costs, as documents are stored in digital form in a central repository like NeSL. Access to such documents would be much easier from a central location or even locally. The data in respect of digitally executed documents can be run through analytics and date mining depending on the meta data submitted at the time of execution. For example, there could be alerts for date of limitation, there can be analysis based on age profile, occupation, income range etc.

Achievement till date

Today almost every bank is on NeSL's DDE platform, many banks have used innovative new products on the platform. The platform has been stress tested to handle the large number of transactions, which usually happens at the end of the month or when special business drives are launched by banks. The banks have used the platform in ways to suit their needs. The most common use case for DDE is for loans in the individual segment. In this segment, documents have been executed in respect of personal loans, education loans, car loans etc. However, even large corporate loans have been executed on NeSL's DDE platform.

A useful use case for DDE is in financial inclusion. Many of the beneficiaries in this segment are from the under privileged segments, they may not have a permanent dwelling or even an Aadhaar linked mobile phone. NeSL has therefore introduced a biometric mode of authentication which captures the fingerprints and authenticates with the Aadhaar database. The Aadhaar based e-sign, whether through mobile or biometric authentication also ensures that basic identity details like date of birth, gender etc. are in accordance with the data provided by the bank. NeSL's integration with portal like Jan Samarth is to ensure a 'plug and play' model where banks have to just integrate with the Jan Samarth portal for a seamless experience of DDE. The Direct Benefit Transfer initiative of the Government of India has ensured direct transfer of various benefits to bank accounts of beneficiaries. The DDE of NeSL can mark a similar transformation, with eligible beneficiaries being available to avail benefits of subsidy linked credit schemes of the government in a seamless manner.

The road ahead

NesL's DDE has been gaining popularity, and more than two million transactions have been done. However, it's only a few banks which have taken the lead. The adoption must be across the banking industry to make a difference to the ecosystem.

While the traction in the corporate segment is very encouraging, the overall adoption is very low. Many banks find the business case for use of DDE in the corporate segment less appealing. Firstly, the numbers are much less to require machine processing through DDE. Further, in the corporate segment documentation is also an opportunity for banks to develop and reinforce relationships with senior executives of corporates. However, it is a segment where a central document repository like the IU can be useful. It could help in business continuity where a change in management happens through an IBC process or through mergers and acquisitions (M&A). In India, secondary loan market transactions are very few and for some time RBI has been trying to facilitate this. Secondary Loan Market Association has also been set up for this purpose and it has already started its operations. If documents are in a central repository like NeSL, initial due diligence by a potential acquirer of the business or the loan would be simpler, subsequent transfer of title and security interest could also happen in a seamless manner on the NeSL portal. In case there is a need to initiate insolvency proceedings, documents can flow seamlessly from the NeSL portal to the e-filing portal of the AA.

Many banks require documentation solutions for other needs like application forms, nomination forms etc. NeSL has now started offering solutions for such requirements. The advantage is that all documents related to a customer and linked to a PAN are at one place. It can easily be made available for an inspection or audit or for the purpose of doing due diligence as part of the M&A process.

NeSL has also started offering services for issuance of electronic bank guarantee (e-BG). NeSL's e-BG addresses all the challenges in the existing physical process of issuance of a BG like reduction in time required for issuance and difficulties in verification of the authenticity of the same. As expected, in today's era of instant messaging, NeSL's e-BG becomes available immediately on issuance, to the beneficiaries. The beneficiary gets a message on issuance of the BG, a simple and one time process of registration is required to be done, after which the beneficiary can access the BG in electronic form on the NeSL e-BG portal. In the physical process, the BG has to be delivered by courier or in person to the beneficiary after which the beneficiary has to do a tedious process of verifying the authenticity of the same. Moreover, on invocation, in a physical BG, the original BG has to be produced before the issuing bank. NeSL's e-BG provides a digital mode for all life cycle events in the BG like cancellation, extension or invocation. It reduces time at all stages. It increases customer convenience and enhances ease of doing business.

How DDE benefits insolvency ecosystem

At the time of initiation of insolvency proceedings creditors are required to enclose copies of documents as proof of debt. This is an extremely arduous process as loan documents often have hundreds of pages and each page has to be individually signed. When these documents end up at the office of the AA, examination and storage of such tomes of paper is an equally challenging task.

A digitally executed document can easily be uploaded on the e-filing portal of AA. As it is digitally signed and sealed, its authenticity can be easily established. Digitally executed documents can be stored easily in NeSL portal or on a standalone basis without taking up precious real estate. They can also be easily referred to using search tools if required. Thus, overall document management improves, both for the creditor and the AA.

The IU is widely regarded as one of the four pillars of the Code and it is there to assist the IPs at every stage of the insolvency process. NeSL offers an integrated case management system for the entire corporate insolvency resolution process (CIRP), beginning from the time when the demand notice has to be given by an OC to a debtor. Claim management is one of the major processes of a CIRP and NeSL offers a fully digital solution which helps manage the process. Till date it has processed thousands of claims in CIRPs of real estate companies with ease and in reasonable time. There is a requirement of Virtual Data Room (VDR) for any M&A or acquisition through CIRP. NeSL offers secure VDR services, and the IPs have the comfort of availing services from an entity regulated by IBBI.

Wishlist

DDE is being used in the corporate segment and many of these documents require to be filed with Registrar of Companies. A link with the portal of Ministry of Corporate Affairs e-filing portal would not only facilitate filing requirements, but would also ensure a clean, digitally signed, and authenticated document is available on record for viewing by authorized persons. This can also be an additional use case for digital execution of documents in the corporate segment where traction is less compared to the individual segment.

The First Schedule of Information Technology Act, 2000 (IT Act) lists out the documents for which the Act shall not apply. In September, 2022, the IT Act was amended to provide for digital execution of documents like any contract for the sale or conveyance of immovable property or any interest in such property. This was a major development as home loans constitute a large and growing segment of the personal loan portfolio of most banks. The intent of the Government was to ensure that even such documents are executed digitally. However, where registration is required for mortgage related documents, the process is still physical. The relevant documents after digital execution need to be printed and taken up separately for registration. A straight through process of registration with a link to NeSL's DDE platform would make the entire journey digital and greatly benefit the ecosystem.

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Information Utility – An Indian Innovation

- Namisha Singh

'When digital transformation is done right, it's like a caterpillar turning into a butterfly, but when done wrong, all you have is a caterpillar.'

- George Westerman

INTRODUCTION

With more than half a billion internet subscribers, India is the largest 'connected' nation in the world and one of the largest and fastest-growing markets for digital consumers.[1] Looking at the digital capabilities of India, technology is assured to radically change nearly every sector of India's economy.

India has a rich history of establishing digital platforms. Around 30 years ago, the Indian banking system was introduced with the Core Banking solutions. Core Banking Solutions is the networking of bank branches, which allows customers to manage their accounts, and use various banking facilities from any part of the world. This dawned the new phase of growth and efficiency of Indian financial system.

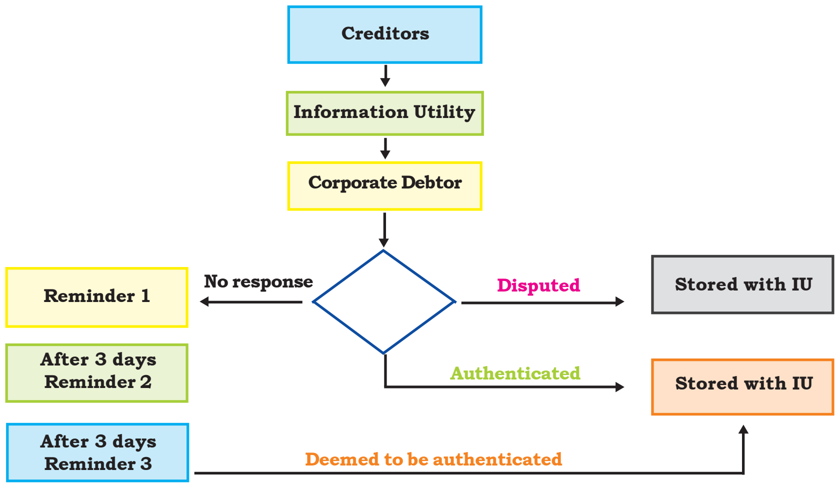
Thereafter, in late 1990s, India ushered in dematerialisation of securities. A revolution in the securities market initiated to automate the securities contracts. The securities and contracts were dematerialised and executed online.

In a similar fashion, the Bankruptcy Law Reforms Committee (2015) chaired by Sh. T. K. Viswanathan recommended processes to resolve insolvency and bankruptcy in India.[2] The Committee visualized the concept of a competitive industry of 'Information Utilities' (IUs) which holds information of firms at all times digitally and makes available the relevant information to stakeholders in resolving insolvency and bankruptcy. It envisioned the concept of IU, one of the four pillars supporting the institutional framework of resolving insolvency, others being Insolvency Professionals (IPs), adjudication infrastructure at the National Company Law Tribunal (NCLT) and the Debt Recovery Tribunal (DRT), and a regulator, the Insolvency and Bankruptcy Board of India (IBBI/Board). The IUs in India were conceptualised in the backdrop of Credit Information Companies and the Central Registry of Securitisation Asset Reconstruction and Security Interest (CERSAI) which was established under the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002, to register security interests to financial credit contracts that are secured by an underlying asset. An IU is an electronic repository of financial information, including loans and related agreements. IU is a novel concept, unique to the world, it has no parallel in the existing universe. With the registration of its first IU in 2017, India has entered the uncharted territory that can make a substantial contribution to the financial ecosystem, especially to the insolvency ecosystem.

IU UNDER THE IBC

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) envisages IUs as repositories of financial information about debtors.[3] They are authorised to maintain electronic database of information and provide authentic information to eliminate delays and disputes relating to claims, defaults, assets and liabilities of debtors in various processes under the Code. They are mandated to provide core services in respect of financial information, which include: (a) records of the debt of a person, (b) records of liabilities when a person is solvent, (c) records of assets of a person over which security interest has been created; (d) records, if any, of instances of default by a person against any debt; and (e) records of the balance sheet and cash-flow statements of a person. The IBBI (Information Utilities) Regulations, 2017 (IU Regulations) provides that a person can acquire or hold up to 10% of the paid-up equity share capital or total voting power of an IU. However, a government company; stock exchange; depository; bank; insurance company; and public financial institution can acquire or hold up to 25% of the paid-up equity share capital or total voting power of an IU. These provisions do not apply to the holding of shares or voting power by the Central Government or a State Government.

As on date, one IU, namely, National e-Governance Services Limited (NeSL), promoted by bank and financial institutions is registered with the IBBI. To avail IU Services, an entity/department concerned, represented by its authorized officer is required to undertake and complete the process of user registration on IU's platform. Under the Code, a financial creditor (FC) under section 7 of the Code along with application for initiation of corporate insolvency resolution process (CIRP) is required to furnish a record of default from an IU or other record or evidence of default as may be specified. Further, section 9 of the Code provides for the operational creditor (OC) to furnish a copy of any record with IU along with application for initiation of CIRP. This 'Record of Default' (RoD) is issued by the IU after the authentication of the information received from the users registered with the IU in Form C provided under IU Regulations. Form C captures exhaustive details of user, debt, parties to debt, default, proof of debt, security and default etc. However, an IU can modify the information which may be accepted from the user in this Form as it deems fit. The process flow of authentication of default by an IU is presented below:



Process of authentication of default

USE OF IU IN THE INSOLVENCY ECOSYSTEM

The initiative of establishing IU is a one-of-a-kind initiative to aid the IP and related stakeholders in swift initiation, processing and closure of an insolvency resolution process under the Code. The insolvency resolution process requires exhaustive use of financial information. An IU, therefore, is required to maintain database of financial information in a centralised form in electronic format.

The Technical Committee on IUs (2017) chaired by Sh. R. B. Barman recommended the Technical Standards for IUs.[4] These standards ensure and enforce the reliability, confidentiality and security of financial information to be stored by IUs. These technical standards have been adopted in the form of guidelines and in accordance with these guidelines an IU is required to accept and provide financial information and issue record of default. An IU serves the information to an IP on one platter in the form of RoD. This helps in subsiding the delay in admission of application for initiation of insolvency resolution process. The financial information available with the IU makes it immensely beneficial for the insolvency ecosystem. Some of the benefits of the IU are listed below:

a) **Timely completion of CIRP –** The Code provides for a competitive industry of interoperable IUs to store financial information that helps to establish defaults, verify claims, constitute committee of creditors based on claims, and generate information memorandum. The digital platform provided by an IU facilitates the completion of an insolvency resolution process in a time bound manner.

b) **Readily accessible information –** With the consent of a corporate debtor (CD), a user registered with the IU can access the credit exposure of the CD from its institutional creditors. This information comprises of details of indebtedness of the CD i.e., debt, default, overdue, credit history, security provided to the creditors, etc. The creditors of the CD can have access to this financial information readily available with the IU. Further, regulation 21(4) of the IU Regulations provides for the IU to communicate the information of default post authentication to the registered users including creditors.

c) **Rich database of information –** The Code has ensured that the IUs record the financial information pertinent for the resolution of insolvency. Section 215(2) of the Code makes it mandatory for an FC to submit information relating to assets in relation to which any security interest has been created. Also, the Code obligates an IU to accept electronic submissions of financial information from persons who intend to submit the financial information to the IU.

d) **Accurate storage of information –** The Code provides that the information submitted to an IU shall be authenticated by all concerned parties before storing such information. The verification of the records from the concerned parties ensures the accuracy of the information.

e) **Information asymmetry –** An IU acts as a financial information management system addressing the fundamental problem of asymmetric information between creditors and debtors. As the same information of a CD is available to all the stakeholders through IU platform, it reduces the problem of asymmetric information.

f) **Single source of truth –** Section 7(3)(a) of the Code provides that FC along with application for initiation of CIRP shall furnish a record of default from an IU. Similarly, section 9(3)(d) of the Code provides that OC along with application for initiation of CIRP shall furnish a copy of any record with IU. The RoD issued by the IU is recognized as an acceptable record under the IBC to facilitate the Adjudicating Authority (AA) to form an opinion that a default has occurred and based on such opinion AA may admit such application. It enhances the experience of AA in scrutinization of the documents for admission / rejection of application of an insolvency resolution process. It can be said that the record of default can serve as 'a single source of truth' facilitating the AA in swift admission of applications.

In addition to the above listed benefits, the importance of an IU stands discernible from the recommendations of reports of the Insolvency Law Committee (ILC). The Report of the ILC[5] (2020) chaired by Sh. Injeti Srinivas has suggested steps for the speedy commencement of insolvency proceedings. The Committee recommended to enforce compliance with section 215 of the IBC which provides for submission of information by creditors to an IU and incentivise provision of information to IUs. It also suggests that eventually section 215 may be amended to require every creditor, apart from FC, to also provide financial information to IU. Further, it suggests phasing out reliance on the records that are not stored with IUs while filing applications for initiation of CIRP.

The report of the ILC[6] (2022) chaired by Sh. Rajesh Verma recognised that the availability and acceptability of the records available with IU has increased. It further acknowledged that the IU records can help in swift admission / rejection of a CIRP application by expediting the process of proving default. The Committee has recommended that certain FCs should be mandated to submit IU records along with their CIRP application. Further, it recommended that the AA should not seek any other documentary evidence for proving default when IU records are submitted by the applicant. A similar mandate may be extended to OCs in due course of time.

STATUS OF IU

The IU has the potential to be of extensive use to the stakeholders. It is a platform providing easy access to authorised persons through online mode based on a robust mechanism of verification of identity of a user.

As on date, India has only one IU, namely, NeSL. Since its inception in 2017, NeSL has entered into domains like digital document execution (DDE) i.e., digital execution of loan agreements and enabling of instant execution of contracts digitally. The principle of the NeSL-DDE platform is to digitise all the steps of the document / agreement execution journey. These include submission of information and document / agreement to be executed on the platform, flexibility to accommodate any agreement / document format, consent-based process, digital payment of stamp duty and affixing of digital e-stamp certificate, verification of the identity of the executants and digital execution using an electronic signature and secure storage transmission and retrieval of the digitally executed document generated using the platform.

Furthermore, with the support of IBBI, NeSL offers a platform for distressed assets which is a web-based portal for the IPs. It facilitates the IPs to deliver their duties efficiently and effectively. Under PDA, NeSL offers the services like market place for interim finance, invitation of expression of interest from resolution applicants, invitation and evaluation of resolution plans and auction platform during liquidation.

The IBBI newsletter for quarter ending March, 2023 provides the details of information available with IU.[7] Table given below presents the details of information held by NeSL as on March 31, 2023:

Particulars	Financial Creditors	Operational Creditors
Creditors who have submitted information	770	1204
No. of debtors for whom information is submitted	18391569	11529
No. of loan records received by IU	25946358	333694
Amount of underlying debt (₹ crore)	18829291	53691

Source: IBBI newsletter for the quarter January – March, 2023

The platform of IU can be of utmost use and relevance to the stakeholders if they realise the duties assigned to them under the Code. IBC provides that for an FC to mandatorily submit financial information to the IU relating to assets in relation to which any security interest has been created. In support of IBC, the Reserve Bank of India (RBI) vide notification[8] dated December 19, 2017 advised all FCs regulated by RBI to adhere to the provisions of IBC and IU Regulations and put in place appropriate systems and procedures to ensure compliance to the provisions of the Code and regulations.

It can be said that the concept of IU has ascended with flying colours. Economic Survey 2022-23 published by the Government of India has a reference to the services provided by NeSL under the chapter 10 'Services: Source of strength' titled as 'Dematerialization of Documents: The next wave of digitization' (Page 309, Box X.6).[9] The relevant excerpt provides:

> In line with the objective of the Digital India mission, which seeks to transform India into a digitally empowered nation, National e-Governance Services Limited (NeSL), an Information Utility registered with and regulated by the Insolvency and Bankruptcy Board of India under the aegis of the IBC 2016, introduced the Digital Document Execution (DDE) platform in 2020. This was done at the behest of the Insolvency and Bankruptcy Board of India and with the support of the Department of Financial Services (DFS), Ministry of Finance.
>
> .....
>
> The NeSL-DDE platform eliminates the need for the physical presence of the executants and the manual process to be carried out for executing documents / agreements. By doing so, the platform generates several benefits, such as lower execution time and cost, a secure system, authorised access, bulk processing, fraud prevention, legal robustness, and evidentiary value. A significant enabler in the journey of digitisation of documents / agreements in the financial sector is the use of the Aadhaar e-Sign, which has made electronic signatures widely available to citizens at a nominal cost.
>
> The NeSL-DDE platform has garnered the support of state governments, ministries, and financial institutions. DFS has been encouraging banks to consider adopting DDE for their agreements. Currently, 23 States and

Union Territories are available for digital e-stamping on the NeSL DDE platform. 27 banks and NBFCs are using the platform for executing their agreements, and so far, more than 9 lakh transactions have been undertaken. This includes small-ticket consumer lending transactions to large-value corporate lending transactions.

One use case of the NeSL-DDE platform is the electronic bank guarantee (e-BG), which takes away all the issues and challenges associated with the issuance, transfer, and management of physical bank guarantees and brings inefficiencies of time and cost savings. As the adoption of e-BG picks up, the NeSL platform can also function as a central repository of bank guarantees. Recently, the Department of Expenditure has amended the General Financial Rules, 2017, to permit the acceptance of e-BG in the government procurement process.

While the initial use case of NeSL-DDE is financial documents / agreements, the platform shall also enable the digital execution of other documents / agreements. This secure, paperless, hassle-free contracting offered by NeSL-DDE will have significant implications on the ease of doing business in the nation.

STEPS TAKEN BY IBBI FOR STRENGTHENING THE STRUCTURE OF AN IU

The Board vide various amendments to IU Regulations, has taken steps to strengthen the structure of IU.[10] Some of the amendments are listed below:

- The Board vide amendment dated April 13, 2021 to IU Regulations, mandated the bye-laws of an IU to provide for minimum service quality standards including timelines for registration of users, issuance of record of default, and issuance of annual statement to the registered users. It also mandated for adoption of quality standards and quality standards certifications by an IU.
- Further, the amendments dated April 13, 2021 introduced timelines for updating information by users. It provided that the user who has submitted information shall update the information at monthly intervals within a week from the end of the month. Further, the information of default shall be submitted within seven days of its occurrence. The very intent of the amendments was to build a robust repository of accurate and secure information so that the stakeholders can benefit from the information available with the IU.
- Thereafter, the Board vide amendment dated June 14, 2022 to IU Regulations, with the intention to strengthen the IU, provided that before filing an application to initiate CIRP under section 7 or 9, the creditor shall file the information of default, with the IU and the IU shall process the information for the purpose of issuing record of default.

- The amendments dated June 14, 2022 also provided that an IU shall deliver the information of default to the debtor at their postal or email address recorded with MCA 21 and the CERSAI registry as repositories, or any other statutory repository as approved by the Board.

The Ministry of Corporate Affairs in consultation with IBBI has released a discussion paper on January 18, 2023, inviting comments from public regarding amendments being considered in the Code.[11] The discussion paper provides that it is being considered to increase reliance on the record submitted with the IUs during the admission process. It is being contemplated that before making an application to initiate the CIRP, the relevant information regarding the occurrence of a default or dispute may be ascertained at the IUs by the FCs, OCs and CDs. When applying under sections 7 and 9, the evidence stored with the IUs will be required to be produced before the AA, which can be relied on for speedy default verification and swift initiation of the CIRP.

Further, it is being considered that the Code may be amended to provide that while considering an application filed under sections 7 and 9, the AA will only rely on the record of the default available with the IUs to determine if a default has taken place. Further, to strengthen the sanctity of the record of the default available with the IUs, it is also being considered that such a record will be conclusive proof about the occurrence of a default. However, there may be circumstances where the record is not available with the IU. In such limited cases, the AA, on genuine reasons to be shown, may consider other evidence.

CHALLENGES BEFORE IU AND PROBABLE SOLUTIONS

Data privacy: The Indian insolvency ecosystem as on date has only one IU in the country which was registered in the year 2017 with IBBI and has since been holding the mantle of the IBC to assure information symmetry. The concept of IUs is yet to establish pre-eminence in the area of credit information management and credit analysis. Even when IU is one-of-a-kind institution, the debtors, creditors and other stakeholders hesitate in utilising the services offered by an IU. As the concept of IUs is based on usage of technology, the stakeholders find it difficult to trust technology for sensitive financial information fearing privacy, misuse, breach, or leakage.

Submission of record of default along with application for initiation of CIRP: The Registrar, Principal Bench New Delhi vide order dated May 12, 2020[12] mandated submission of RoD from the IU as evidence of debt and default along with the petitions filed by FCs under section 7 of the Code for initiation of CIRP. However, the order of Hon'ble High Court of Calcutta[13] in August, 2020 came as a major setback for IUs, wherein, the order of Registrar, Principal Bench New Delhi was overturned after receiving a representation by several FCs challenging the order of Registrar, Principal Bench New Delhi.

Authentication of information: When processing the information received by an IU, it assigns a unique identifier to the information it receives from the user. It acknowledges the receipt of the information so received and notifies the user of the unique identifier of information, the terms and conditions of authentication and verification of information, and the manner the information may be accessed by other parties. In case of information regarding default, as soon as the IU received the information, it initiates the process of authentication and verification of the information received from the user. On completion authentication and verification, the IU categorise the information in three categories, namely, authenticated (coded in green colour), deemed to be authenticated (code in yellow colour) and disputed (coded in red colour). These categories indicate the status of authentication of the information of default i.e., green colour for debtor confirming the information of default, yellow colour when debtor does not respond even after three reminders by the IU and red colour when debtor disputes the information of default. However, the requirement of categorisation has changed vide amendment to the IU Regulations dated June 14, 2022 in case of FCs which are banks included in the second schedule of the Reserve Bank of India Act, 1934. For such FCs, there will only be two categories i.e., authenticated (includes deemed to be authenticated) and disputed.

The E-Newsletter of NeSL for the quarter January – March 2023 provides the details of information available with NeSL.[14] It provides that for FY 2022-23, in the category of financial credit standard loan data, the number of loan records authenticated are 8.02 lakh and the number of loan records on-boarded are 259.46 lakh. This implies that only 3% of the records are being authenticated in the category of financial credit standard loan data.

Additionally, in case of default reported loans, for FY 2022-23, the number of loan records authenticated are 6.11 lakh and number of default reported loans are 13.44 lakh. Thereby, implying that in case of default reported loans, only 45% of the records are being authenticated, which also includes 'deemed to be authenticated' categorisation of set of information of default available with NeSL.

For the purpose of maintaining the evidentiary value of a record of default before the AA, it becomes pertinent for an IU to have authenticated set of data. In addition to the standard methods being adopted by NeSL like sending reminder email / letters to the CDs, NeSL may explore the idea of organizing structured programs for spreading awareness about its services and benefits of authentication to the stakeholders.

INTERNATIONAL PRACTICE

The United States Trustee Program[15] (USTP) is a constituent of the United States Department of Justice that seeks to promote the efficiency and protect the integrity of the United States Bankruptcy System. To further the public interest in the just, speedy, and economical resolution of cases filed under the Bankruptcy Code. The program monitors the conduct of bankruptcy parties and private estate trustees, oversees related administrative functions, and acts to ensure compliance with applicable laws and procedures. To ensure the integrity of the bankruptcy system, the USTP carries out a broad range of administrative, regulatory, and enforcement activities, and relies on its information systems and technology to carry out its mission.

The USTP maintains information systems and several applications and data collections that are stored on servers connected to the USTP's Justice Consolidated Network (JCON), which is the platform on which all USTP's servers and systems reside. The USTP's JCON system maintains various applications that permit the USTP to collect, organize, analyze, and disseminate information more efficiently. This information includes bankruptcy case related records as well as records about USTP employees, contractors, and volunteers, records related to internal case management, litigation support, financial reporting, and Privacy Act requests, and administrative personnel services and functions. JCON also provides a platform for the USTP's network infrastructure, including hardware, e.g., servers, workstations, laptops, tablets, network switches, requisite cabling, and smartphones interconnected by the Justice Unified Telecommunications Network (JUTNet) and software. The system allows all offices nationwide to be connected, and all users rely heavily on JCON as their portal to access data, applications, printing, and email services, however, USTP personnel are the sole users of JCON and the applications that reside on it.

WAY FORWARD FOR IUs

Considering the details of information available with the only registered IU i.e., NeSL, it is certain that the data available with the IU is substantial. Going forward, reliance is to be made on expanding coverage of information with NeSL. As already noted in preceding paragraphs, IU shall explore on spreading awareness by organising structured programs about its services and benefits of authentication to the stakeholders to build in trust among the stakeholders fearing privacy, misuse, breach, or leakage. NeSL can also explore the role and use of artificial intelligence in protecting the stored financial information stored. Artificial intelligence provides constant oversight even when the human resources are off duty. Cybersecurity software that uses artificial intelligence can take advantage of machine learning technology to make smart decisions regarding potentially suspicious traffic.

Moreover, it can also be explored to encourage the financial institutions while extending credit to a borrower above a threshold to keep a requirement for the borrower to mandatorily authenticate the financial information with an IU. It can also be considered to mandate creditors extending credit above a threshold to any person to submit financial information to an IU.

The IU Regulations provide for porting of information from registries by an IU. The IU Regulations has already recognised MCA 21 and the CERSAI registry as repositories approved by IBBI. MCA-21 is a project of the MCA acting as the repository of the financial statements of corporate entities. Further, CERSAI is a Government of India company, a registry providing for a central database to integrate records of property registered under various registration systems. It has a registration system for registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property. To strengthen and expand the information available with an IU, efforts can be made to port information from these repositories.

Considering the objective of creating an IU as 'single source of truth', similar arrangements can be worked out with other repositories by their seamless integration for finer realisation of credit risk, reducing the expense of compliance for the regulated entities and subsiding the duplication of efforts made by the submitter of information in submitting the same information to different repositories.

[1] Annual Report 2022-23, Ministry of Electronics & Information Technology.

[2] Report of the Bankruptcy Law Reforms Committee, November, 2015.

[3] Section 210, IBC.

[4] Report of the Technical Committee on Information Utilities, August, 2017.

[5] Report of the Insolvency Law Committee, February, 2020.

[6] Report of the Insolvency Law Committee, May, 2022.

[7] IBBI Quarterly Newsletter, January – March, 2023.

[8] RBI notification dated December 19, 2017.

[9] Economic Survey 2022-23.

[10] IBBI (Information Utilities) Regulations, 2017.

[11] MCA Discussion paper dated January 18, 2023 inviting comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016.

[12] Order by Registrar, NCLT Principal Bench New Delhi, May 12, 2020.

[13] *Univalue Projects v. Union of India*, 2020, High Court of Calcutta No. 3347 of 2020.

[14] E- Newsletter for Quarter January – March 2023 by National e-Governance Services Limited.

[15] Privacy Impact Assessment for the USTP Justice Consolidated Office Network dated August 29, 2022.

Part IV

Learnings and Outcomes

14

Private Credit: An Emerging Success Story

- Pratik Datta and Rajeswari Sengupta

INTRODUCTION

Worldwide, non-financial companies typically depend on debt capital from banks or bond markets, or equity capital from public markets for external financing. This is especially the case for the large, established companies. Over the last few years, this landscape has been witnessing a new development — the emergence of the 'private credit market' that is more geared towards providing capital to the smaller firms or firms that are not able to access the traditional sources of financing. Private credit refers to debt, which is not publicly traded like many corporate bonds, and is originated or held by non-bank lenders. This new trend has been picking up pace both in the developed and in the emerging economies.

Private credit in India has been described as non-bank lending in high yielding and illiquid investments using debt-like instruments.[1] This form of credit has always existed in India through non-banking financial companies (NBFCs) and mutual funds (MFs). However, the prolonged period of balance sheet stress in the banking sector that manifested as high levels of non-performing assets (NPAs) from roughly 2013 to 2019 and the crisis in the NBFC sector triggered by the default of IL&FS (Infrastructure Leasing and Financial Services) in September, 2018, pushed the traditional institutional sources of corporate finance to start focusing more on retail lending. On the other hand, the MFs in India confined their lending activities primarily to companies with a credit rating of 'A-' and above. These developments disrupted the supply of patient and flexible debt capital to mid-market, lower rated companies.

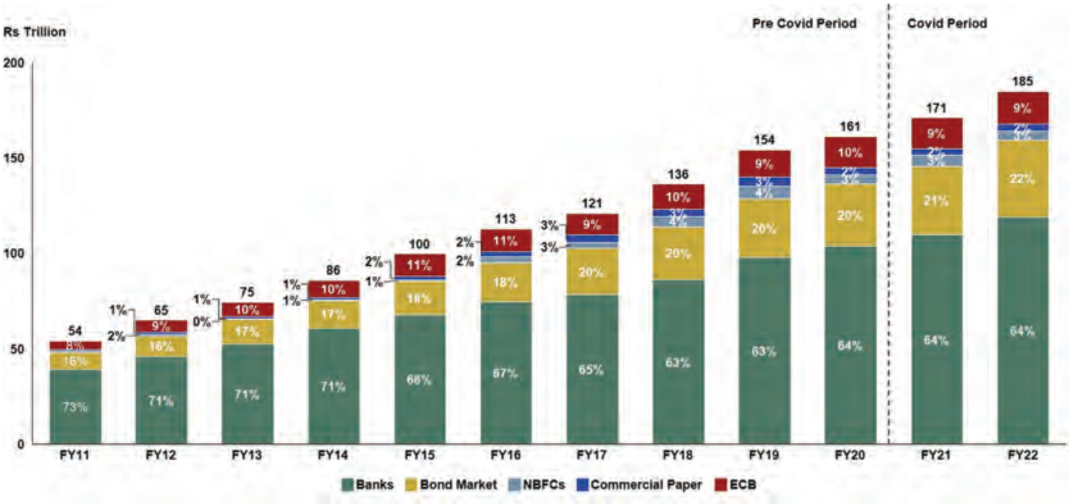
Alternative investment funds (AIFs) that operate in the private credit space have been increasingly occupying this financing void. This is a relatively new phenomenon in the Indian credit landscape. In this article, the authors analyse the development of the private credit market in India, discuss the advantages of developing this market and also highlight some challenges. The enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), arguably, was one of the important factors that supported the development of the AIF-driven private credit market in India. In fact, this may be considered one of the most inspiring success stories of the corporate insolvency law reforms since 2016. Hence, the authors also attempt to identify policy actions in the corporate insolvency space that might help to further facilitate the growth of this market.

DECLINE IN COMMERCIAL CREDIT

One of the most significant developments in recent times in the credit landscape of India has been the decline in the growth of commercial (non-government) credit. Total commercial credit growth declined from 16.4% in 2011-2015 to 10.1% in 2015-2020.

Figure 1 below shows the evolution of the shares of the traditional credit sources over the period from 2011 to 2022. Historically banks have been the largest providers of commercial credit in India. During the last decade their share in total commercial credit fell from a peak of 73% in 2011 to 64% in 2022. Corporate bond issuances and NBFCs filled the gap created by the shrinking of bank credit. The share of the bond market went up from 16% to 22% over the same period and the share of NBFCs (net of borrowing from banks and bond market) also inched up.

Figure 1: Shares of various credit sources in total credit, 2011-2022



Source: Sengupta and Vardhan (2022)

Note: Numbers on the stacks depict share in total credit. Years are financial years ending March of that year. Total credit refers to total commercial or non-government credit; credit by NBFCs is net of credit from banks and bond market to them.

During the 2011-2022 period, of all the sources of commercial credit, bank credit grew at the slowest pace at only 11.3%.[2] The rate of growth of bank credit fell from 14.6% in 2011-2015 to 8.8% in 2015-2020.[3]

One of the main reasons behind the decline in bank credit was the twin balance sheet (TBS) crisis which manifested in the form of growing NPAs on the balance sheets of inadequately capitalised banks and high levels of debt in financially stressed companies in the private corporate sector.[4] By 2018 the share of gross NPAs in the total advances of the Indian banking sector was as high as 14%; it was even more acute for public sector banks (PSBs) whose NPAs amounted to nearly 20% of their total loan book. To deal with the TBS crisis the Reserve Bank of India (RBI) introduced the Asset Quality Review (AQR) program in 2015-16 which forced the banks to recognise the NPAs on their balance sheets. This was followed by the Prompt Corrective Action (PCA) program which imposed strict conditions on banks, especially PSBs with very high levels of NPAs.

The actions taken by the RBI and the government triggered risk aversion in the banking system.[5] It also led to a decline in the share of industrial credit in total bank credit. The share of total industry (large and MSME firms) in bank credit declined from 44% in 2011 to 31% in 2020. The growth rate of credit to industry declined sharply from 15.4% in 2011-2015 to 1.9% in 2015-2020 whereas credit to MSMEs contracted. Banks withdrew from lending to the private corporate sector and instead began focusing on lending to the retail sector. Consumer credit as a share of total bank credit went up remarkably from 19% in 2011 to 30% in 2020, causing a trend of 'consumerisation of credit' in Indian banking during this period.[6]

As the share of banks in total commercial credit fell, NBFCs emerged as important credit providers. Between 2011-2015 and 2015-2020, the growth rate of credit from NBFCs went up sharply from 5% to nearly 45%. Between 2014-15 and 2019-20, the share of NBFCs and HFCs (housing finance companies) in institutional credit (i.e., credit from banks and non-bank financial institutions) increased from 20% to 27%, net of bank credit.

However, the NBFC sector faced a big blow with the default of IL&FS in September, 2018, which sent shockwaves through the banking system as well as the debt markets – the two biggest funding sources for NBFCs. This was followed by other relatively low-impact shocks due to problems in NBFCs such as DHFL (Dewan Housing and Finance Limited) and IndiaBulls Housing Finance as well as in Yes Bank. These events further worsened the risk appetite of the banks and triggered risk aversion in the debt markets as well.[7]

By the start of the COVID-19 pandemic in 2020, bank credit growth reached a size-decade low of barely 6%. By the time the pandemic subsided and as the Indian economy began recovering from the shock, the health of the banking sector also improved substantially. Successive waves of recapitalization by the government gave the PSBs enough resources to write off most of their bad loans. As a result, they were able to bring down their gross NPAs to 5.9% in 2021-22. Most of the Indian banks now hold comfortable levels of capital and credit growth has also picked up. In 2022-23 bank credit grew at more than 15%. The resumption of bank credit growth, however, has been primarily driven by growth in unsecured consumer credit and home loans, and to some extent by MSME credit which grew on the back of the credit guarantee scheme (ECLGS) launched by the government during the pandemic. Lending to industry has not shown any substantial improvement. The RBI's latest Financial Stability Report shows that the growth rate of bank loans to industry fell to from close to 10% in 2021-22 to 4.9% in 2022-23.[8]

In addition to the decline in bank credit to industry, another notable trend of the last decade has been the increase in the share of bonds in total commercial credit. In fact, over the last decade, the growth rate of credit through bonds outpaced credit from banks. Having said that, the size of the corporate bond market is small in India in comparison to not only developed markets, but also some of the other emerging market economies. For instance, corporate debt to GDP ratio in India was only 17% in June 2017, as compared to 123% in the US, 74% in South Korea, 44% in Malaysia, 99% in Brazil and 19% China (RBI, 2019).

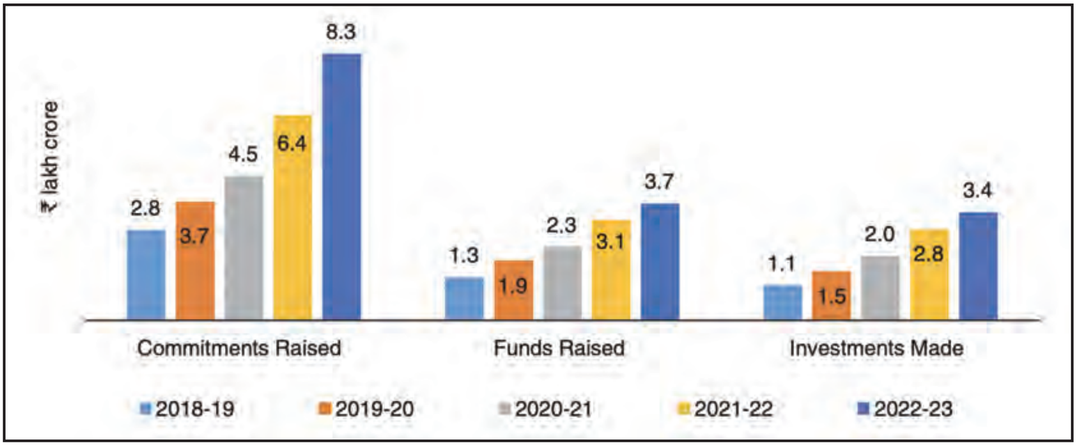
The bond market in India suffers from several problems. To begin with, it is highly skewed. It is accessible only to the large, established and top-rated (and hence low risk) companies. More than 85% of bonds issued are rated AA and above, whereas bonds rated BBB and A, which are technically 'investment grade', find very few investors in the bond market. Also, public sector enterprises and NBFCs account for bulk of the issuances.[9] Secondly, even though the primary market issuances of bonds have maintained a strong trajectory over the last decade, the secondary market is still highly illiquid. With over ₹ 40 trillion outstanding bonds, daily trading volume rarely goes beyond ₹100 billion. The secondary market trading is also limited to a small set of bonds. An extreme example of this effect was witnessed in the IL&FS default episode of 2018 when the bonds issued by IL&FS, that were completely illiquid, were downgraded from AAA to D almost overnight, leaving many investors stranded. One reason for this high level of illiquidity is that the dominant investment pools in the bond market, the insurers and pension funds, are 'buy and hold' investors who do not normally trade in bonds. Finally, more than 90% of the bonds issued in India are of less than 5-year maturity. This implies that credit for long-term projects which carry higher risk are hard to come by in India.

EVOLUTION OF AIFs

The unfolding of the credit landscape as described above created a conducive environment for the emergence of AIFs in India especially over the last 5-6 years. A growing amount of capital is now being invested in bonds through these credit AIFs which under the SEBI nomenclature are called AIF Category 2. This signals the emergence of a the private credit market.

Over the last few years AIFs have been one of the most rapidly growing segments in the credit landscape. As shown in Figure 2, AIFs have seen significant growth in terms of commitments raised, funds raised, and investments made since 2018-19. Category 2 AIFs, which include funds for distressed assets, accounted for 73% of the overall funds raised by AIFs.[10]

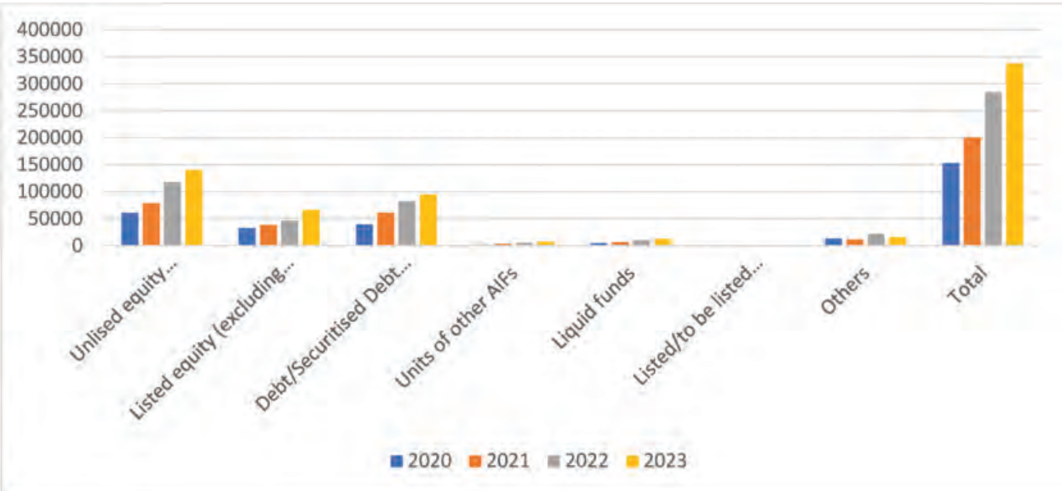
Figure 2: Growing AIF Ecosystem



Source: SEBI

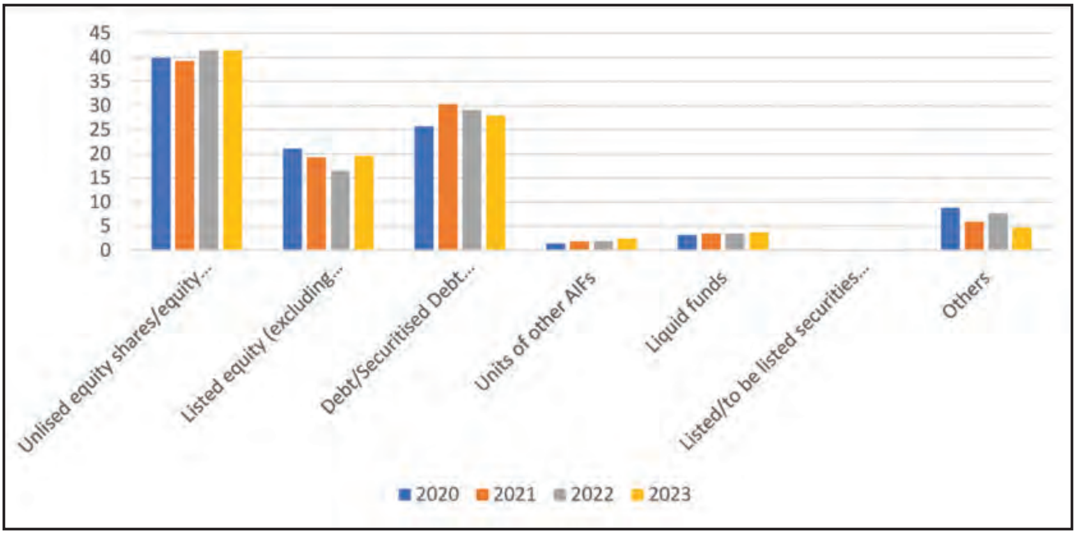
AIFs deploy funds across various instruments such as unlisted equity shares/equity linked instruments/LLP interest, listed equity, debt/securitised debt instruments, units of other AIFs, liquid funds, listed/to be listed securities on SME Exchange etc. As shown in Figure 3, debt and securitised debt instruments received the second highest amount of investments from AIFs between 2020 to 2023. As shown in Figure 4, AIFs invested around 25-30% of their funds in debt or securitised debt instruments during this period.

Figure 3: Instrument-wise deployment of funds by AIFs (Amount in Rs. Crore)



Source: SEBI

Figure 4: Instrument-wise deployment of funds by AIFs (as % of funds invested)



Source: SEBI

While the exact 'Assets under Management' of credit AIFs are not publicly available, they are estimated to be about ₹ 1 to 1.5 trillion. Despite being a small percentage of the total credit, they are performing a very important role in widening the issuer base of bonds.

By nature these AIFs seek higher returns and hence higher risk. A majority of them invest in bonds that are right above or below the investment grade, implying that these funds invest in bonds ranging from A to B credit rating. Consequently, SEBI's investor protection norms prohibit them from accepting investments of value less than ₹ 10 million.[11] This minimum threshold does not apply to high net worth investors classified as 'accredited investors' under SEBI Regulations.[12] It is assumed that such high value investors will be 'informed' and hence be able to bear the risk inherent in these investments. Therefore, high net-worth individuals, family offices, corporate treasuries, etc., are the most common investors in these funds. Increasingly, foreign portfolio investors are also investing in these AIFs.

While on one hand the heightened risk-aversion in the banking sector in the wake of the TBS crisis paved the way for the emergence of credit-AIFs, these funds also provide a better model for wholesale credit compared to the NBFCs whose inherent fragilities arise from asset liability mismatches on their balance sheets. As a result of the growing presence and penetration of the AIFs, better risk distribution and capital allocation through the markets might take place.

While these funds can perform a critical role, that of developing the bond market for lower rated securities, they also present a different kind of regulatory challenge. Credit AIFs in India are quite small in size today and hence they have not yet attracted enough regulatory attention, though that seems to be changing in recent times. Currently, credit AIFs get clubbed in the AIF Category II along with private equity funds and their corpus is not separately reported. Since SEBI started regulating AIFs in 2012, there have been 24 amendments to the SEBI (AIF) Regulations, 2012. 75% (18) of these amendments were from 2020 onwards. These amendments have focused on improving governance and transparency of AIFs as well as investor protection. Going ahead, regulators will have to encourage the development of these funds so that the bond market becomes deeper. At the same time, risks arising from this market will need to be better understood, monitored and managed through norms on governance, reporting and disclosures, etc.

It is also important to recognize that apart from the withdrawal of banking sector from industrial credit and the skew of the corporate bond market towards high rated companies, another factor that may have played a critical role in the rise of the AIF-driven private credit market in India was the enactment of the IBC in 2016. Unlike banks and NBFCs, AIF lenders are not legally allowed to use the enforcement rights under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).[13] AIFs also cannot use the RBI's out-of-court restructuring mechanism.[14] The primary statutory instrument that effectively safeguards AIFs' interests in loans or debt investments in companies is the IBC. Consequently, the AIF-driven private credit markets will benefit enormously from a better functioning corporate insolvency law regime. The remaining part of this paper will focus on the relevant policy actions in this regard.

POLICY ACTIONS

'*If the proposed law be unique – be utterly without analogy in civilized communities of modern times – suspect its soundness.*'

- Raja Sir Tanjore Madhava Rao[15]

a. Statutory Waterfall

Earlier this year, a discussion paper was floated proposing various amendments to the IBC. This discussion paper proposed a unique amendment to the statutory waterfall under section 53 of the IBC. The proposal states:[16]

> As per this scheme, creditors will receive proceeds up to the CD's liquidation value for their claims in the order of priority provided in section 53. Any surplus over such liquidation value will be rateably distributed between all creditors in the ratio of their unsatisfied claims. Finally, any remaining amount or further surplus would be distributed

to the shareholders and partners of the corporate debtor, as the case may be.

While the policy intent to make the distribution process fairer and equitable is laudable, the proposed distribution mechanism appears to have no comparable precedent in any major economy. In fact, it runs contrary to the most well-accepted tenets of corporate finance which prioritize security interest in full. Consequently, if this proposal is implemented, it is likely to have unforeseen consequences for most market players and concluded loan facilities. This would be especially disruptive for secured creditors, including AIFs, and derail the growth in the nascent AIF-driven private credit market. It would be wise instead to continue with the current formulation of section 53 and leave its equitable implementation to incremental evolution in case-law jurisprudence and market practice.

b. Pre-packs

Pre-packaged administrations (or pre-packs) could be extremely useful for resolution of mid-market companies. Compared to a full-blown insolvency resolution, pre-packs are likely to be quicker and cheaper, and may also help avoid the perceived 'stigma' associated with insolvency. A functional pre-pack mechanism could therefore be a major boost for AIF lenders.

Globally, pre-packs have evolved organically without state-supplied laws. This usually happens when the insolvency regime becomes stable and the outcome predictable. A distressed company's management can then privately negotiate with the majority creditors (with adequate voting rights), prepare a workable resolution plan, and then approach the court for approval. The job of the court becomes simpler. It needs to check if the resolution plan is compliant with the law, especially the rules on protection of minority creditors. Once it is certain that the resolution plan is legal, the court can approve the plan. Evidently, pre-packs do not require a separate elaborate legislative framework. It develops mostly on its own through private initiative, case-law jurisprudence and market practice.

Indian policymakers have sincerely tried to develop a prepack regime. Chapter III-A was inserted into the IBC and the prepack rules were issued in 2021. Yet, pre-packs have not taken off. Till March 31, 2023, only 4 prepack applications have been admitted. One of the primary reasons for this lukewarm response is the overtly rigid and elaborate statutory framework for prepacks.

A better solution would be to adopt a simple legal provision in the IBC enabling National Company Law Tribunals (NCLTs) to admit pre-pack applications (prior to any payment default) without tying them down to any pre-defined rigid statutory procedure. This would allow NCLTs to incrementally innovate flexible mechanisms to handle pre-packs on a case-by-case basis and allow market practice to evolve organically. Insolvency and Bankruptcy Board of India could softly nudge this process through knowledge exchange workshops between Judges, Insolvency Professionals and lawyers from India and other foreign jurisdictions where pre-packs are commonly used. State supplied laws and regulations may be required at a future point in time if pre-packs are used extensively for abusive 'phoenixing' transactions.[17]

c. Debt Restructuring

Indian law provides three routes to debt restructuring.[18] First, the RBI's June 7, 2019 Circular provides an out-of-court restructuring option. Second, the IBC could be used for restructuring under the aegis of the NCLT. Third, a scheme of arrangement under the Companies Act, 2013, could also be used for debt restructuring through the NCLT.

The third route is sparingly used in practice. Restructuring is not particularly easy under the first option either. The June 7 Circular applies only to RBI-regulated lenders and requires them to enter into an inter-creditor agreement (ICA). Non-RBI regulated entities (such as AIFs, Mutual Funds) can neither use the June 7 Circular nor are they legally bound to sign the ICA. And without signing the ICA, there is no way to cram down dissenting creditors. This arrangement limits the practical utility of the June 7 Circular for debt restructuring.

The IBC does not suffer from any such limitations. It applies to all claimants of the corporate debtor (CD), including all lenders and bond investors, whether regulated by the RBI or SEBI. This provides a more holistic restructuring framework compared to the June 7 Circular. Moreover, financial creditors with 66% voting share on the committee of creditors (CoC) can cram down the dissenting financial creditors (FCs). Therefore, a resolution plan cannot be upheld by a minority group of creditors under the IBC. Lastly, the IBC provides a statutory moratorium on recovery actions by all claimants. This assures every creditor that no other creditor can engage in an asset grab race during the restructuring process.

In spite of these advantages, there remains much room to improve the debt restructuring potential of IBC. For instance, IBC is currently designed primarily to facilitate going concern sales, not debt restructuring. Debt restructuring is a 'hypothetical sale' to the existing lenders and need not require submission of resolution plans from external third party buyers. Plans by third parties are necessary for going concern sales. Yet, the IBC provides the same process for both going concern sales as well as debt restructuring.

To resolve this deficiency, a new chapter on debt restructuring, broadly modelled after Chapter 11 of the US Bankruptcy Code 1978, could be inserted into the IBC with the following basic features:[19]

(a) Allow filing of a restructuring application by a CD which is experiencing financial distress but has not yet defaulted.

(b) Impose a temporary moratorium on any suit or legal proceedings against such CD from the time of filing. To minimise the risk of misuse of the moratorium by a debtor, the decision to extend the moratorium period must be left solely to the commercial wisdom of a simple majority of the CoC. The law must not permit any judicial discretion to extend the moratorium period unilaterally.

(c) Allow a debtor-in-possession regime during the moratorium period so that after admission into the restructuring process, the existing management could continue running the business as a going concern while negotiating with the CoC to finalise and approve a restructuring plan.

(d) Make it mandatory that the distribution of value through a restructuring plan must comply with the waterfall under section 53 of IBC.

The proposed debtor-in-possession model will incentivise the management of a financially distressed business to immediately start private debt restructuring negotiations with the majority FCs much before any default event actually occurs. This will help preserve the value of the distressed business and improve the chances of a successful debt restructuring. The management as well as majority FCs will also have strong commercial reasons to cooperate and opt for pre-packs, avoiding unnecessary adversarial litigations. Overall, the proposed reforms will enable a healthy restructuring ecosystem to develop under the IBC, thereby benefitting all lenders including the credit AIFs.

CONCLUSION

AIFs are emerging as reliable suppliers of patient and flexible debt capital to the mid-market, lower rated companies. This is a relatively new phenomenon in the Indian private credit market. Apart from the withdrawal of the banking sector from industrial credit and the skew of the corporate bond market towards high rated companies, another factor that may have played a critical role in the rise of the AIF-driven private credit market in India was the IBC which was enacted in May, 2016.

If this private credit market flourishes and starts catering to an increasingly larger segment of high-risk businesses, this may relieve some of the pressure faced by the overburdened banking system and may encourage the commercial banks to do better allocation of capital, perhaps more and more to the retail sector. This can eventually lead to the emergence of a credit landscape in India where large, highly rated companies directly access debt capital through the corporate bond market, the vast majority of medium and small sized, lower rated companies access debt capital through the AIFs, and the banking system predominantly caters to the retail sector.

A supportive corporate insolvency law regime will substantially benefit this fledgling private credit market. The authors offer three suggestions in this regard. First, the current formulation of the statutory waterfall under section 53 of the IBC should be continued. Second, the elaborate statutory framework for prepacks in the IBC should be replaced with a simple legal provision enabling NCLTs to admit pre-pack applications (prior to any payment default) without tying them down to any pre-defined rigid statutory procedure. This would allow NCLTs to incrementally innovate flexible mechanisms to handle pre-packs on a case-by-case basis and allow market practice to evolve organically. Third, IBC is currently designed primarily to facilitate going concern sales, not debt restructuring. To resolve this deficiency, a new chapter on debt restructuring should be inserted into the IBC, broadly modelled after Chapter 11 of the US Bankruptcy Code 1978. A debtor-in-possession regime for debt restructuring as in the USA would better align the incentives of the management with the majority FCs, automatically fostering a healthy restructuring ecosystem under the aegis of the IBC.

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[1] EY 2021, p. 7.

[2] The authors report here the compounded annual growth rates or CAGR.

[3] Sengupta and Vardhan (2022).

[4] Government of India 2017; Sengupta and Vardhan (2017, 2019).

[5] Sengupta and Vardhan (2020a).

[6] Sengupta and Vardhan (2021).

[7] Sengupta and Vardhan (2020b).

[8] RBI (2023).

[9] Sengupta and Vardhan (2023).

[10] SEBI Annual Report 2022-23, p. 2.

[11] Regulation 10(c), SEBI (AIF) Regulations, 2012.

[12] Regulation 2(ab) read with second proviso to Regulation 10(c), SEBI (AIF) Regulations, 2012.

[13] 'Financial institutions' as defined in section 2(1)(m) of SARFAESI Act, 2002 can use the enforcement rights under that statute. AIFs are not covered in this definition.

[14] AIFs are not covered within the definition of 'lender' under this circular. RBI, Prudential Framework for Resolution of Stressed Assets, June 7, 2019.

[15] Sagar R., "The Progressive Maharaja – Sir Madhava Rao's Hints on the Art and Science of Government", HarperCollins Publishers India, 2022, p. 61.

[16] Ministry of Corporate Affairs, Notice: Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016, January 18, 2023, para 9.6.

[17] Datta P. and Sinha S. (2017), "Promoter buy-back in insolvency: 'Phoenixing' in India", Oxford Business Law Blog, December 15.

[18] Datta P. and Marwah V. (2020), "IBC suspension will hurt debt restructuring process", *Hindu Business Line*, May 1, 2020.

[19] *Ibid.*

15

Lessons From Pre-Packaged Insolvency Cases in India: A Long Road Ahead

- M. P. Ram Mohan and Sriram Prasad

INTRODUCTION

Insolvency regimes experiment and evolve, responding to the needs of the market. The Report of the Sub-Committee on pre-packaged insolvency resolution process (PPIRP) noted that the introduction of the pre-pack insolvency scheme represents such an evolution of the Indian insolvency regime.[1] In the aftermath of the COVID-19, the Pre-pack Committee stated that it was the 'right time to introduce pre-packs in India' as there was a likelihood of an increase in insolvency cases.[2] Pre-pack insolvency aimed to ease the burden of the Tribunals and Courts, as the final resolution would be consensually negotiated between the financial creditors (FCs) and the debtor. Thus, insolvency would be 'pre-packaged' - it would be presented before the court along with an initial resolution plan, for judicial approval.

The aim of PPIRP is a speedy and more cost-effective resolution, with lesser disruption to business than the corporate insolvency resolution process (CIRP).[3] To achieve these goals, the pre-pack framework in India consciously shifted away from many procedures and practices as seen in a CIRP while trying to maintain the core features of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code).

The Pre-pack Committee recommended a phased rollout of PPIRP, envisaging it to eventually becoming available for all corporate debtors (CDs).[4] For the first phase, the Committee recommended 'the size of default which is objective rather than on the size of the company' as a criterion.[5] However, the legislative rollout of pre-packs was based on the size of the company which they limited to MSMEs under the MSME Act, 2006.[6]

Pre-pack insolvency was notified on April 4, 2021. In the two years following the introduction of pre-pack insolvency, there have only been eight cases (as on May 31, 2023). In this paper, authors have analysed the timeline of the cases and explored the challenges faced. Authors undertook unstructured interviews with lawyers who were involved in the PPIRP cases to understand their perspectives. As the paper only engages with lawyers involved in PPIRP cases, a comprehensive stakeholder perception study is beyond the scope of this research.

INITIATING A PPIRP

To initiate a PPIRP, the MSME should have committed default of an amount of at least ₹ 10 lakh.[7] The defaulting MSME i.e. the CD requires approval of at least 66% of the unrelated FCs to initiate a PPIRP (section 54A(3)). The FCs will then identify a Resolution Professional (RP) for guiding the PPIRP (section 54A(2)(e), 54C(3)(b)). The CD has to prepare a base resolution plan for review by the FCs (section 54A(4)(c)). These are the key requirements, among other procedural requirements, needed to initiate a PPIRP.[8] The application is to be filed before the National Company Law Tribunal (NCLT).

Once a PPIRP application is submitted, it must be admitted or rejected within 14 days. If the NCLT rejects the application, it has to provide seven days for the CD to rectify any defects in the application.

Once admitted to the PPIRP, a resolution plan has to be submitted to the NCLT within 90 days (section 54D), with 30 days provided to NCLT to either approve or reject the plan (section 54L). If no resolution plan is submitted within 90 days, the PPIRP is terminated (section 54D). Alternatively, a PPIRP can end if 66% of the committee of creditors (CoC) approves the termination of the PPIRP and the NCLT passes an order terminating the PPIRP (section 54N, 54-O).

The statutory timeline envisaged for the PPIRP is provided in *Annexure 1*. Part IIIA of IBC provides various requirements such as safeguards towards transparency of information (sections 54C, 54G, 54K); interest of operational creditors (OCs) (section 54K); deterring malfeasance (sections 54F, 54G, 54K) amongst others.

The interplay of the PPIRP (section 54A) and CIRP (under sections 7, 9 and 10) before the Tribunals is covered by section 11A of the IBC. In three of the eight cases filed, the Tribunal faced the issue of applicability of section 11A. Section 11A was introduced along with the pre-pack insolvency amendment, and provides the manner of giving precedence to either the PPIRP or CIRP. Section 11A provides as follows:

- PPIRP to prevail when,
    - PPIRP applications filed first; or
    - PPIRP is filed within 14 days of the CIRP application.
- CIRP to prevail if the PPIRP application is filed more than 14 days after a CIRP application.
- CIRP to prevail if the CIRP application was filed before the pre-pack amendment was introduced.

UNDERSTANDING THE EIGHT CASES WHICH ATTEMPTED TO INITIATE A PPIRP

As discussed above, so far only eight applications have been filed to initiate pre-pack insolvency, of which only six have been admitted. Of the six admitted, one was withdrawn before resolution. Of the five remaining cases, only one case has seen resolution under PPIRP. Currently four cases remain pending as on May 31, 2023.

In this section, the authors discuss the course of these eight cases.

Table 1: Overview of applications filed under Part IIIA of IBC

Sl.	Case name	Industry	Date of default	Date of admission	Outstanding debt (₹ in approx.)	No. of FCs	Cause of default
Resolved							
1.	Amrit India[9]	Trading and Consultancy	Not provided	28.11.22	12 lakh (Financial) 25 lakh (Contingent)	1	Defunct + COVID
Admitted and Pending							
2.	GCCL Infrastructure and Projects[10]	Construction	31.12.20	14.09.21	54 lakh	Not Avail-able	Not Available
3.	Enn Tee International Limited[11]	Manufacture of apparel & supply of yarn	01.04.22	10.10.22	12 crore (Financial) 4.1 crore (Operational)	1	Demon-etisation, GST, COVID
4.	Shree Rajasthan Syntex [12]	Manufacture of yarn	15.09.20	19.04.23	30.8 crore (Financial) 7.8 crore (Operational) 1.8 crore (Workers)	3	Financial management and regulation of pet coke in Rajasthan
5.	Sudal Industries Limited [13]	Manufacture of aluminium extrusions and base alloys	21.02.19	20.04.23	132 crore (Financial) 9 crore (Operational)	10	Not Available
Admitted and Withdrawn							
6.	Loon Land Developers Limited[14]	Real Estate	16.07.21	29.11.21	> 10 lakh (Operational)	Not Avail-able	Not Available
Withdrawn prior to admission							
7.	Krrish Realtech[15]	Real Estate	08.10.21	NA	673 crore	Not Avail-able	Not Available
Dismissed							
8.	CHD Developers[16]	Real Estate	12.07.22	NA	Not Available	Not Avail-able	Not Available

The authors begin by examining the two unsuccessful cases, as it helps better contextualise the six cases which were admitted.

The two unsuccessful cases

In *Krrish Realtech Private Limited* (Krrish Realtech) the application for PPIRP was withdrawn prior to its admission. In *CHD Developers Limited* the application for PPIRP was rejected in favour of CIRP. CHD Developers Limited is currently under appeal.[17]

Krrish Realtech Private Limited

In the case of *Krrish Realtech*, there was substantial debt due, involving numerous FCs and homebuyers from incomplete real estate projects.[18] Objections against the PPIRP application were filed soon after its filing with the NCLT. Notices were issued, and the objecting parties were in the process of being heard. Response had been sought from Krrish Realtech to the objections raised.

The objections claimed that the PPIRP application was not filed properly and the consent of the FCs was not taken as mandated under the IBC.[19] In response, Krrish Realtech filed an appeal before the NCLAT seeking that the objections be heard after the admission of the PPIRP application. They argued that PPIRP under IBC did not allow the hearing of objections during the admission process. The objectors argued that the manner of filing the PPIRP application indicated Krrish Realtech's malafide and fraudulent intentions.

The NCLAT upheld NCLT's decision to hear the objections.[20] NCLAT *prima facie* found that the regulations had not been complied in obtaining approval of the FCs for filing the PPIRP application. NCLAT reasoned, when an application under section 54C did not fulfil the statutory requirement, a person having a claim in PPIRP could point out the infirmity and object to the admission of an improper application. The NCLAT further held that NCLT was guided by the principles of natural justice, and it was appropriate to provide reasonable time to file the objections.[21] Subsequent to the decision of the NCLAT, Krrish Realtech withdrew the PPIRP application. The time taken from the date of filing to the date of withdrawal was 137 days.

CHD Developers Limited

CHD Developers Limited initiated the application for PPIRP while CIRP applications by homebuyers were already pending before the NCLT. The CIRP applications under section 7 had been filed prior (in October, 2020) to the coming into effect of the PPIRP ordinance providing for PPIRP. In these cases, CHD admitted the default and did not dispute the section 7 application.[22]

The NCLT had to determine whether to admit the pending section 7 petition or the newly filed section 54C application. Section 54C covers the procedure to initiate an application and section 54A covers eligibility. The NCLT drew upon section 11A(4) of the IBC, which states that if a section 7 application was filed before the coming into effect of Part IIIA of IBC, then the order of precedence provided under section 11A (1), (2), and (3) would not be applicable. Accordingly, the PPIRP application was rejected. In this case, the time taken between the date of filing and the rejection of the PPIRP application was 55 days. The decision of the NCLT is currently under appeal. [23]

The six cases admitted to PPIRP

The six cases which were admitted to PPIRP can mainly be divided into two categories. In the first, the key question was the completeness of the PPIRP application. In the second, the issue pertained to the conflict between section 7 and section 54A applications. The latter dealt with similar questions as discussed in the *CHD Developers* case above.

4 cases on completeness of the PPIRP application

While the facts of all four cases are different, the primary question before the NCLT was the completeness of the PPIRP application. These four cases were:

1. GCCL Infrastructure and Projects Limited
2. Loon Land Developers Limited
3. Enn Tee International Limited
4. Amrit India Limited

In the case of both *GCCL Infrastructure* (Annexure 2) and *Loon Land Developers* (Annexure 7), no significant clarifications were sought by NCLT prior to the admission. In the case of GCCL, there was a default towards FCs; while in the case of Loon Land Development, the default was towards OCs.

In *Enn Tee International Limited* no significant clarifications were sought by the Tribunal, and a minor defect was corrected prior to admission of the application (Annexure 3).

In the case of *Amrit India Limited*, the main issue related to the admissibility arose, due to the filing of a defective application before the NCLT. The application did not include a base resolution plan. The Tribunal granted additional time for clearing the defect. The base resolution plan was then filed 49 days after the filing of the initial application (Annexure 4).

The Tribunal's approach to all these cases was similar. Upon finding that all the statutory requirements were fulfilled, the Tribunal admitted the PPIRP applications. In all four orders admitting the PPIRP application, the Tribunal listed out all the requirements under the IBC to initiate a PPIRP (under sections 54A, 54B, and 54C) and observed how these had been complied with and fulfilled in the PPIRP application. The time taken between the filing and the admission of the application for the four cases on average was 79 days.

Application of Section 11A in two cases of admission

In *Shree Rajasthan Syntex* and *Sudal Industries Limited,* both section 7 and section 54A applications were filed. The cases are discussed in detail below.

a. *Shree Rajasthan Syntex*

Shree Rajasthan Syntex Limited (SRS), a publicly listed company had incurred losses since 2015 and was negotiating with the consortium of banks to restructure the loan. The three banks were—State Bank of India (SBI) [50.73% of debt], Industrial Development Bank of India (IDBI) [28.39% of debt], and Bank of Baroda (BoB) [20.88% of debt]. While engaged in negotiations, BoB unilaterally filed a section 7 application without informing the consortium or SRS. Consequently, SRS filed a PPIRP application.

BoB objected to the PPIRP application, and its main arguments were:

a) SRS was not an MSME under the criteria revised by the Ministry of MSME under notification dated June 26, 2020.

b) The PPRIP application was filed as a response by SRS after BoB had filed a section 7 application to initiate a CIRP.

The Tribunal observed that in the given case, BoB filed a section 7 application on April 18, 2022, post which notices were issued on May 4, 2022. The PPRIP application was filed on July 26, 2022. However, SRS submitted, the process to initiate PPIRP had commenced in March 2022 – when SRS had obtained consent to initiate PPIRP from SBI on March 29, 2022 and IDBI on April 13, 2022.

The Tribunal noted that BoB at the time of filing its CIRP application on April 18, 2022, was aware that an effort to file a PPIRP application was underway. Consequently, the Tribunal held that BoB's CIRP application was in bad faith – as more than 66% of the FCs had already approved the PPIRP scheme.

NCLT allowed the PPIRP application, finding it in the interest of all the stakeholders; even though the PPIRP application was filed after the 14 days period provided under section 11A(2). The Tribunal also questioned the practicality of allowing a CIRP where more than 75% of the FCs favoured initiating a PPIRP. Regarding whether SRS was an MSME, the Tribunal was satisfied with SRS's MSME certificate and SBI and IDBI's submission that SRS was an MSME. Consequently, the Tribunal dismissed the CIRP application and admitted the PPIRP application, 267 days after it was filed.

b. *Sudal Industries Limited*

Sudal Industries Limited (Sudal), a publicly listed company, had submitted a PPIRP application while two CIRP applications were already pending. Of the two petitions, one was filed by Canara Bank (Canara) on July 17, 2020 which held 78.09% of total financial debt and had consented to the PPIRP. The other petition was filed by Jaldhara Properties & Trading Private Limited (Jaldhara) on December 9, 2020 which held 10.56% of the financial debt. Jaldhara objected to the PPIRP application and requested the Tribunal to decide the section 7 petition first, as was mandated under section 11A (4).

On examining section 11A (4), the Tribunal found that the law mandated examining the section 7 petition first. Be that as it may, the Tribunal observed both section 7 and section 54A intended to achieve the same goal, which was resolution of insolvency. As Canara had consented to the PPIRP application, NCLT dismissed its CIRP application as infructuous. The Tribunal further found that Jaldhara's '*opposition stems from its intent to displace the existing promoter(s) from its management than to resolve the Corporate Applicant*' and held that the application was not '*in accordance with the intent and object of the code and deserve[d] to be dealt with accordingly*'. Thus, the Tribunal found Jaldhara's application not maintainable.

After dismissing both section 7 petitions, the Tribunal found the section 54A application to be complete and admitted Sudal to PPIRP, 228 days after the initial filing of the PPIRP application. While this case was similar to *CHD Developers*, the Tribunal distinguished the case on facts and held that in *CHD Developers*, the CD had not disputed the section 7 application as was not the case in *Sudal Industries*.[24]

The lone resolution till date: Amrit India

While pre-pack insolvency seems to be relatively straightforward, there has been only one resolution so far—the approval of the resolution plan of *Amrit India* by NCLT.

In the case of Amrit India, there was only one FC. Amrit India declared insolvency due to worsening relations with the FC, where the FC refused to provide further credit. The business was incorporated in 1981, and had been defunct since 2019. It also claimed to have been adversely affected by COVID-19. Consequently, Amrit India initiated PPIRP and proposed a base resolution plan with a 90% haircut for the FC and a 100% impairment of rights of contingent creditors. The CoC in its second meeting rejected the base resolution plan after Amrit India was unable to improve its plan and invited resolution plans from prospective resolution applicants.

The CoC received only one resolution plan from Aquarius Fincaps and Credits Private Limited (Aquarius). At the request of the CoC, some modifications to its resolution plan were made by Aquarius. Thereafter, in its 5th meeting, the CoC approved Aquarius's resolution plan. As per the plan, Aquarius was to pay ₹ 5 lakh to the FC against the amount of ₹ 12.7 lakh and provide ₹ 2.2 lakh for contingent claims valued at around ₹ 25.6 lakh. No amount was due to any OC per the information memorandum. The Tribunal approved the resolution plan after reviewing its compliance with the requirements under the IBC.

The whole process from the date of admission to the date of approval of the resolution plan took 156 days. Additionally, it took 75 days for a complete application to be filed with the Tribunal (Annex 4). Thus, bringing the total time spent between filing and approval to 231 days. This included three adjournments at the request of the CD.

NCLT'S APPROACH TO PRE-PACK CASES

Examining the eight cases shows that the time taken to process the initial application varies widely based on the complexity of the case. Ranging from 38 days taken in *Loon Land Developers* case to 267 days in *Shree Rajasthan Syntex.* If the application is incomplete or where there are some procedural shortcomings, the current practice adopted by the NCLT allows persons with claims to object. These objections would be heard before admitting the application. *CHD Developers*, *Shree Rajasthan Syntex* and *Sudal Industries Limited* are illustrative in this regard. In *CHD Developers*, the Tribunal accepted the objection and initiated a CIRP. In *Shree Rajasthan Syntex* and *Sudal Industries Limited*, only when the Tribunal heard and dismissed the objections, it examined the PPIRP applications.

The current status of the pending PPIRP cases highlights the difficulty in meeting the prescribed timeline. The problems faced and their causes are discussed below.

Protracted PPIRP cases

An application once filed has to be decided within 14 days. If the Tribunal finds a defect with the application, the Tribunal has to provide 7 days for the applicant to correct the defect. Once admitted, pre-pack insolvency is to be completed within 120 days. This means from the date of filing, a PPIRP has to be completed within 134 days (+7 days in case of a defect being corrected). Once PPIRP is initiated, the CD has 90 days to submit a resolution plan and the IBC envisages 30 days for the court to either approve or reject the plan. The timeline mandated for PPIRP under the IBC is provided in Annexure 1. However, for the timelines to be met in practice, this requires speedy hearings, submission of complete information, straightforward transactions, etc.

GCCL Infrastructure is illustrative of the bottlenecks that lead to delays in resolution. These bottlenecks are present not only in the case of PPIRP matters, but in many cases being dealt by NCLT. In *GCCL Infrastructure*, the application was filed on June 6, 2021. After the registry scrutinised the application, the application was registered on June 27, 2021. The first hearing occurred on September 6, 2021 when the NCLT sought a clarification. On September 14, 2021, the NCLT admitted the petition. However, after admitting the petition, the case was plagued with delays, as illustrated in Annexure 2.

In *GCCL Infrastructure,* 694 days had elapsed between the date of filing upto May 31, 2023, and the case is still pending. This case is symptomatic of the delay in approving the resolution plan. Since its filing, till May 31, 2023, there have been a total of 18 adjournments, of which 14 were due to paucity of time, or absence of the regular bench.

Of the other cases, in *Loon Land Developers Limited* there were a total of 13 adjournments, including five due to paucity of time. The CD and the RP had sought the other eight adjournments. The case spent approximately 16 months in the system (483 days) before it was withdrawn (Annexure 7). In *Enn Tee International Limited,* post admission, nearly 200 days have been taken by the CoC to consider the resolution plan (Annexure 3).

The only case to see resolution, *Amrit India Limited* was admitted on November 28, 2022. Amrit India took 231 days from the date of filing and 156 days from the date of admission to be resolved - as seen in its timeline in Annexure 4.

The review of the six admitted cases shows the average time taken between filing and admission was 135 days, against the mandated 14 days period under section 54C(4). In trying to understand the challenges faced in the pre-pack application process and its adjudication, the authors conducted unstructured interviews with some of the lawyers involved with PPIRP cases. These insights are discussed in the next part.

INSIGHTS INTO THE WORKING OF THE PRE-PACK PROCESS

The authors conducted interviews with four lawyers involved with PPIRP cases. They were, Mr. Ishan Shah[25] (involved with *GCCL Infrastructure*), Ms. Prachi Johri[26] (involved with *Enn Tee International*), Ms. Varsha Banerjee[27] (involved predominantly with *Amrit India* and, to a certain extent, with *Loon Land Developers*) and Mr. Prakul Khurana[28] (involved with *Shree Rajasthan Syntex*).

The unstructured interviews with the lawyers provided various insights and three common themes emerged - a) Source of delay; b) Hesitancy in utilising PPIRP; and c) Specific insights.

Source of delay in the PPIRP cases

All the lawyers agreed that there was much delay caused in PPIRP cases, as was evident in their timelines.

Ms. Varsha Banerjee noted that while lack of infrastructure was a problem, it was a problem across the Judiciary, not endemic to pre-pack insolvency. Ms. Banerjee also remarked that pre-pack insolvency was time sensitive—lose time and lose the advantage pre-pack insolvency offers. In this regard, Ms. Banerjee suggested some time could be saved if the NCLT registry scrutinised pre-pack cases on priority. Similarly, Mr. Ishan Shah suggested that the NCLT registry could adopt a checklist approach. Mr. Shah also noted that NCLT, in a general sense, was overburdened, which explained the time taken between filing the application and the date of the first hearing.

As seen in the timelines, significant time was lost as the judges were involved in other benches, or the matter could not be taken up due to paucity of time. In this regard, Ms. Prachi Johri observed, some time was always lost in adjournments. She also noted how initially, section 7, section 9 and section 10 petitions took time to be admitted when the IBC was newly enacted. Ms. Johri though is optimistic, believing that as judges deal with more cases and become more familiar with pre-pack insolvency, cases would be disposed of faster. Mr. Prakul Khurana noted that the Tribunal and judges have some leeway to try to ensure faster resolution in PPIRP cases. In this regard, the role played by judges gains significance.

The role played by judges

The judges' unfamiliarity with PPIRP caused some delay, according to Ms. Johri. In her case, the judges' had many questions. Ms. Johri made a checklist of the required documents to address all these questions. Ms. Johri then submitted the checklist along with the documents to the judges to address their concerns, after which the application was admitted. As noted by all the lawyers, the requirements are relatively straightforward and do not require a thorough examination by the NCLT at the admission stage in the first instance. Nonetheless, they observed judges to have a significant role in how quickly a case is resolved.

Mr. Khurana, in his experience noted how the judges were conscious of the legislative intent of the PPIRP and wanted to adjudicate the matter quickly. However, Mr. Shah's experience in GCCL was different, where GCCL was plagued with much delay. Mr. Shah attributed the significant delay in PPIRP cases to a lack of precedent which limited the practical understanding of how PPIRPs function among the judges. He noted how the lack of precedent partly contributed to some hesitancy the judges have in approving the base resolution plan. According to Mr. Shah, the hesitancy is most observable when resolution plans try to extinguish government dues, where the NCLT does not approve the resolution plan until someone representing the government department appears before NCLT.

Mr. Shah also attributes some hesitancy in approving the resolution plan in pre-pack cases to the fact that the NCLT is unable to internalise that by design, the NCLT is not to be involved in the pre-pack process. According to him, minimising the NCLT's involvement is by design, where the law allows for the CD to be creative to sustain the company during a difficult period. It was stressed that the courts need to develop trust that PPIRP is not a mechanism to cover up or engage in fraud and not be paranoid when the company itself initiates insolvency.

Ms. Banerjee also agrees that there is not much adjudication involved in PPIRP, yet judges take time and ask many questions. Such conduct, as Ms. Banerjee observes, can be attributed to restructuring being viewed with paranoia when a company initiates the restructuring. Ms. Banerjee explains that this paranoia arises from cases of past abuse under the previous insolvency regime. However, Ms. Banerjee stresses that the current insolvency regime, including pre-pack insolvency, does not leave scope for much abuse or fraud. She further notes how PPIRP does not prejudice any creditor, as FCs have to consent and OCs have to be paid in full. Therefore, Ms. Banerjee advocates for a procedural approach similar to what is envisaged in a voluntary liquidation proceeding to speed up the process of approval of PPIRP.

Delays are also attributable to the issuance of notice by the Tribunal to the creditors at the first hearing. Ms. Banerjee believes a notice is, per se, not needed in PPIRP. Mr. Shah attributes the tendency to send a notice to a lack of trust and not being able to appreciate the intent of PPIRP. Ms. Johri opines that sending a notice should be seen on a case-to-case basis. For instance, there is no need for notice where there is only one FC who has already approved the PPIRP, as was the case in *Enn Tee International*.

Mr. Khurana agrees with Ms. Johri and notes that notice is not needed when there is only one creditor or all the FCs have consented. Mr. Khurana also proposes that the creditors can waive notice by being present at the first hearing as they receive advance notice of the hearing. However, according to Mr. Khurana, where there is a dissenting creditor, the Tribunal needs to send a notice to understand the dissenting creditor's objection.

Hesitancy in utilising PPIRP

When asked about the low number of PPIRP cases filed in the two-year period since the pre-pack scheme was introduced, all the lawyers indicated it might take some time and only successful resolution in the current cases can spur more PPIRP applications. However, they provided some reasons to explain the lack of applications so far.

Ms. Johri opines that the bankers would prefer a CIRP to a PPIRP, as a CIRP had the scope to be more competitive. Ms. Johri also believes that the promoters might not have enough funds, especially after COVID-19, to fund their base resolution plans—and hence preferred to try and sustain the company rather than proceed with a PPIRP. According to Mr. Shah, another reason could be that lawyers are not advising companies to use PPIRPs creatively. Mr. Shah further advocates for opening the pre-pack scheme to all companies and not limiting it to MSMEs (which is in some manner a proposal in the 2022 draft amendment).

Ms. Banerjee explained how the delay seen in current PPIRP cases could also disincentivise the use of PPIRP. According to Ms. Banerjee, financial projections and agreeing to any base resolution plan would be based on the current outlook, which may change once the critical time period is over. If PPIRPs are delayed, the base resolution plan which was submitted at the time of the PPIRP application would have less scope for approval. Consequently, the CD may be deterred from initiating a PPIRP, if the base resolution plan proposed by the CD would have less scope of approval—which is one of the predominant advantages a PPIRP offers over a CIRP.

Mr. Khurana opined that the lack of PPIRP cases could also be explained by how bankers at the lower level seem unwilling to take a call on approving PPIRPs and pass the responsibility onward. In this regard, Mr. Khurana observes that the toughest part of PPIRP was getting approval from the banks. In his case, only when SBI took the initiative and approved the PPIRP did IDBI approve the PPIRP, while BoB contested the PPIRP. However, Mr. Khurana also understands why banks may be hesitant—as they have to verify whether the losses are genuine or spurious when consenting to a PPIRP.

Apart from these general observations, certain specific insights were uncovered during the interview, as discussed in the following part.

Specific insights

Ms. Johri observed that as Tier-II cities would see a growing number of PPIRPs in the future, Tier-II bank branches would need to develop infrastructure to deal with PPIRPs at their level, which was not the case in her experience. According to Ms. Johri, such a delay at the creditor's level would endanger the success of the PPIRP, as it has to adhere to strict timelines. Mr. Khurana agreed with Ms. Johri's observations adding that banks must take responsibility for approving PPIRPs.

Mr. Khurana also bemoaned the lack of awareness of how IBC functions among government authorities, specifically stakeholders such as the electricity distribution companies (DISCOMs). Mr. Khurana noted that the electricity DISCOMs are often unaware that the IBC overrides their statutory rights. Hence it is sometimes difficult to implement NCLT's order—as seen in Mr. Khurana's case, where an intervening application was required. While Mr. Khurana acknowledged awareness has improved compared to the initial years, a lot remains desired.

Mr. Shah observed that there is much scope to use PPIRP creatively to try and sustain the company. However, Ms. Banerjee pointed out that PPIRP may only face sector-specific success. All three unsuccessful cases were of real estate companies. Ms. Banerjee observed a lack of transparency amongst real estate companies and, consequently, a lack of trust to be a cause of such failure—which is also reflected in the failure of some real estate CIRPs.

Mr. Shah also observed that the NCLT does not follow the timeline for admissions of applications and the approval of resolution plans and is unlikely to do so. In this regard, Mr. Khurana observed how some issues may arise under section 11A, as was evident in his case. According to Mr. Khurana, section 11A uses language, which when literally interpreted, would not be in consonance with the legislative intent—where the CD is unable to file a PPIRP application within the 14 days period (from the filing of a CIRP application) under section 11A. Mr. Khurana explained this 14 days period arises from the language used by sections 7 and 9, where the application must be admitted within 14 days, which the Supreme Court has held as directory and not mandatory. Therefore, Mr. Khurana opined that the time period under section 11A must also be directory and not mandatory.

According to Mr. Khurana, such an interpretation is needed as getting all the approvals and documentation required for a PPIRP within the 14 days period under section 11A is impractical. Mr. Khurana proposed an alternative solution to comply with the 14 days period—filing a petition within the 14 days period to condone the delay and show that steps have already been undertaken to initiate a PPIRP. Regardless of these issues which may arise under section 11A, Mr. Khurana noted how PPIRP has all the tools it needs to be successful.

As stated before, this paper only engaged in a limited stakeholder analysis and a broader stakeholder analysis is much needed to understand better how all the stakeholders perceive PPIRPs. In that regard, some individual stakeholder insights are available in the public domain. The authors briefly examine one such insight which reflects some of the observations made by the lawyers.

A banker's perspective

A wide-ranging interview on the IBC with Mr. Ashwini Kumar Tewari[29] was published in the April, 2023 issue of the journal 'The Resolution Professional'.[30] In the interview, Mr. Tewari noted that pre-packs had not gained traction in the market as reflected by the number of cases. He opined that the poor response to PPIRPs may be due to the 'promoters of the defaulting MSME [not being] comfortable initiating PPIRP' as it would entail much scrutiny of the affairs of the company and some powers would vest with the RP.

Responding further, he explained that another reason for the lack of market engagement with PPIRPs could be due to hesitancy on the part of the FCs in approving the PPIRP, as a haircut 'is a last resort in the case of CIRP', which would be a 'voluntary one in case of PPIRP'. Mr. Tewari also observed that due to the voluntary nature of the haircut, '[t]here might be fear among operating officials of FCs that such a decision might be subject to scrutiny by various authorities at a later date'.

Mr. Tewari concluded that PPIRPs should be extended to other corporates beyond MSMEs and that awareness drives were needed, which the IBBI should conduct in association with FICCI, ASSOCHAM and other stakeholders. He also generally noted a lack of adjudicating infrastructure and how it caused delays in resolving cases. The interview raises issues, similar to those raised by the lawyers.

CONCLUSION

A law is only as good as its implementation. While PPIRP aims to be efficient and fast, it faces many roadblocks in its implementation for various reasons. To ensure that PPIRP is implemented as envisaged, efforts must be directed at training and spreading awareness amongst NCLT judges and registry, FCs, lawyers, Insolvency Professionals, and other stakeholders. A dedicated pre-packs desk at the IBBI would help in coordinating the effort.

Currently, PPIRP is stuck in a vicious cycle. The market seems to be waiting to see how PPIRPs progress. The process, unfortunately, is taking more time than envisaged as PPIRP is a new concept. This delay may disincentivise the market to use PPIRP, leading to fewer cases and a self-perpetuating cycle. To break this cycle, it is critical to fix the process and implementation issues at the earliest; otherwise, if this situation continues, expanding pre-packs to all types of companies will not find many takers.

Annexure 1

The timeline for a PPIRP provided under IBC

Timeline	Event	Section/Regulation
0	Admission of PPIRP application	Section 54C
+7 days	Constitution of CoC	Section 54-I
+14 days	First meeting of CoC (within seven days of the constitution of CoC)	Section 54-I
+21 days	Publication of invitation for resolution plan	Regulation 43 of IBBI (Pre-Packaged Insolvency Resolution Process) Regulations, 2021
+89 days	Evaluation and approval of resolution plan by the CoC	Regulation 47 and 48 of IBBI (Pre-Packaged Insolvency Resolution Process) Regulations, 2021
+90 days	Application to the Adjudicating Authority for approval of the resolution plan or termination of the PPIRP if no resolution plan is approved	Section 54D
+120 days	Order for approval of resolution plan or termination of the PPIRP	Section 54L

Annexure 2

The timeline of GCCL Infrastructure

Sl.	Date	Action	Timeline
1	6th July, 2021	Filing with the registry	Date of filing (F)
2	27th July, 2021	Registration by the registry after scrutiny	21 days
3	6th September, 2021	First hearing, the Bench sought some clarifications	62 days
4	14th September, 2021	The Tribunal admitted the petition to PPIRP	70 days Date of admission (A)
5	30th March, 2022	Matter adjourned due to paucity of time	A + 197 days
6	4th April, 2022	Matter adjourned due to paucity of time	A + 202 days
7	13th May, 2022	Matter adjourned due to paucity of time	A + 241 days
8	31st May, 2022	The Tribunal sought clarifications from the RP about some details in the accepted resolution plan.	A + 259 days
9	20th June, 2022	The Tribunal sought further details of a merger happening under the resolution plan.	A + 279 days
10	11th July, 2022	Counsel sought an adjournment which was granted	A + 300 days
11	31st August, 2022	Matter adjourned as the Bench was conducting hearings related to a different bench	A + 351 days
12	16th September, 2022	Counsel for resolution applicant complied with order dated 20.06.2022. Respondent's Counsel sought an adjournment	A + 367 days
13	13th October, 2022	The Tribunal observed the pleadings to be complete and ordered the matter to be listed on 1st November, 2022	A + 394 days
14	1st November, 2022	Ordered for listing high on board for 17th November, 2022	A + 413 days
15	17th November, 2022	Matter adjourned due to paucity of time	A + 429 days
16	24th November, 2022	Matter adjourned due to paucity of time	A + 436 days

Sl.	Date	Action	Timeline
17	9th December, 2022	Matter adjourned due to paucity of time	A + 451 days
18	14th December, 2022	Matter adjourned due to paucity of time	A + 456 days
19	22nd December, 2022	Matter adjourned due to paucity of time	A + 464 days
20	6th January, 2023	The matter was ordered to be listed before the Regular Bench on 12.01.2023	A + 479 days
21	18th January, 2023	The Tribunal sought a clarification on the treatment of shareholders under the resolution plan and asked for a reply to be filed within a week.	A + 491 days
22	7th February, 2023	The Tribunal noted the Counsel's reply (to order dated 18.01.2023) and adjourned to 17.02.2023.	A + 511 days
23	17th February, 2023	The Tribunal considered the pleadings to be complete and listed the matter for 02.03.2023.	A + 521 days
24	2nd March, 2023	The Tribunal heard counsels and adjourned.	A + 534 days
25	13th March, 2023	The Tribunal noted Counsel's appearance and adjourned.	A + 545 days
26	30th March, 2023	Matter adjourned due to paucity of time	A + 562 days
27	21st April, 2023	The Tribunal noted that since the bench was reconstituted, matter had to be heard afresh and listed the matter high on board for hearing on 11.05.2023	A + 584 days
28	11th May, 2023	Matter was listed for hearing high on boardon 17.05.2023.	A + 604 days
29	17th May, 2023	Matter adjourned due to paucity of time and listed for hearing on 12.06.2023.	A + 610 days
As of 31st May, 2023			A + 624 days

Annexure 3

Timeline for Enn Tee International Limited

Sl.	Date	Event	Timeline
1	8th June, 2022	Filing with the registry	Date of filing (F)
2	6th July, 2022	Registration by the registry after scrutiny	28 days
3	8th July, 2022	The Tribunal issued notice to respondents and non-applicants, returnable by 12th July, 2021	30 days
4	12th July, 2022	Proxy counsel sought a “short date” and matter was listed for physical hearing for 1st August, 2021	34 days
5	1st August, 2022	Matter adjourned due to paucity of time. In the meantime, the Tribunal ordered for the pleadings to be completed and filed	54 days
6	6th September, 2022	A minor defect in PPIRP application was pointed out by the Counsel who was given seven days to rectify the defect. The defect was that the special resolution by share-holders under section 54A(2)(g) was not filed.	90 days
7	12th September, 2022	Matter was adjourned as Bench was busy.	96 days
8	29th September, 2022	The Tribunal reserved the order.	113 days
9	10th October, 2022	Order admitting the PPIRP application was passed.	124 days Date of admission (A)
10	25th January, 2023	Report filed by the RP taken on record	A + 107 days
11	24th April, 2023	RP’s Counsel sought 15 days as was granted by the Tribunal for the CoC to consider a resolution plan.	A + 196 days
As of 31st May, 2023			A + 233 days

Annexure 4

Timeline for Amrit India

Sl.	Date	Event	Timeline
1	14th September 2022	Filing with the registry	Date of filing (F)
2	21st September 2022	Registration by the registry after scrutiny	7 days
3	26th September, 2022	The Tribunal ordered notice to be issued to respondents and non-applicants to be returned by 4th October, 2022.	12 days
4	4th October, 2022	At the request of the counsel, the Tribunal listed the matter for hearing on 6th October.	20 days
5	6th October, 2022	At request of the counsel, the Tribunal listed the matter for a physical hearing on 11th October.	22 days
6	11th October, 2022	Counsel sought time to rectify the defect of not submitting a base resolution plan with the pre-pack application. The Tribunal granted time till 2nd November to rectify the defect.	27 days
7	2nd November, 2022	The Tribunal heard the applicant and reserved the order on admission of the application.	49 days
8	28th November, 2022	The Tribunal passed on order admitting Amrit India to PPIRP.	75 days Date of admission (A)
9	12th December, 2022	First CoC meeting-the CoC requested the CD to improve the base resolution plan which proposed the FC take a 90% haircut and a 100% write off of contingent debt.	A + 14 days
10	14th December, 2022	Second CoC meeting—the CoC rejected the base resolution plan and invited applications for a resolution plan.	A + 16 days
11	16th December, 2022	The minutes of the first CoC meeting were taken on record along with a list of creditors as submitted by the RP.	A + 18 days
12	16th December, 2022	Third CoC meeting—the CoC approved the evaluation matrix and the deadline to submit the resolution plan which was 31st December, 2022.	A + 18 days

Sl.	Date	Event	Timeline
13	9th February, 2023	Fourth CoC meeting-only one resolution plan was submitted in which the CoC sought some changes.	A + 73 days
14	20th February, 2023	Modified resolution plan was submitted by the resolution applicant.	A + 84 days
15	21st February, 2023	Fifth CoC meeting-the CoC approved the modified resolution plan.	A + 85 days
16	27th March, 2023	At request of the counsel, the Tribunal listed the matter for a physical hearing on 17th April.	A + 119 days
17	17th April, 2023	Counsel for RP submitted that a resolution plan was unanimously approved by the CoC. The matter was listed for a physical hearing on 19th April.	A + 140 days
18	19th April, 2023	Tribunal heard the counsel and reserved the order on approval of the resolution plan.	A + 142 days
19	3rd May, 2023	The Tribunal approved the resolution plan.	A + 156 days

Annexure 5

Timeline for Shree Rajasthan Syntex

Sl.	Date	Event	Timeline
1	18th April, 2022	Bank of Baroda filed a section 7 application	NA
2	26th July, 2022	Filing of the PPIRP application	Date of filing (F)
3	29th July, 2022	Registration of the PPIRP application	3 days
4	4th August, 2022	First hearing—Respondent No. 3 (Bank of Baroda – BoB) disputed the applicant's MSME status and claimed to have filed a section 7 CIRP petition. The Tribunal gave the applicant 7 days to respond to BoB's objections.	9 days
5	6th September, 2022	Counsels appeared on behalf of Respondents 1 (State Bank of India - SBI) and 2 (Industrial Development Bank of India – IDBI) and were given 14 days to file a response, as sought.	42 days
6	29th September, 2022	Counsel for SBI sought time for filing a response. Counsels for both sides suggested an amicable settlement was being explored and sought a short adjournment. The Tribunal accepted the request and adjourned till 1st November, 2022.	65 days
7	1st November, 2022	The Tribunal heard the Counsels and noted the Respondents to have filed the appropriate responses.	98 days
8	29th November, 2022	The Tribunal after hearing the applicant Counsel asked the Respondents to file appropriate responses.	126 days
9	8th December, 2022	The Tribunal could not hear the matter due to the paucity of time and listed the matter for the next day on top of the priority list.	135 days
10	9th December, 2022	The Tribunal heard the Counsels. Counsel for BoB sought time to instruct her client whether to pursue Section 7 application or consent to the section 54A application. The Counsel for SBI objected to BoB causing "unnecessary delay". The Tribunal granted some time and listed the matter for 9th January, 2023.	136 days

Sl.	Date	Event	Timeline
11	9th January, 2023	The Tribunal heard all the Counsels and listed the matter for 23rd January, 2023	167 days
12	23rd January, 2023	The Tribunal heard all submissions and reserved the order.	181 days
13	10th February, 2023	The Tribunal heard an IA filed by applicant to direct BoB not to take any coercive action against the applicant as BoB was attempting to take possession of the applicant's estate. The Tribunal prohibited BoB from taking any coercive action until the PPIRP application had been decided.	199 days
14	19th April, 2023	The Tribunal admitted the section 54A PPIRP application over the section 7 CIRP application.	267 days Date of admission (A)
15	23rd May, 2023	An IA was filed by the applicant against the electricity company which was threatening to disconnect electricity.	A + 34 days
16	25th May, 2023	The Tribunal instructed the electricity company to not disconnect the connection and charge the disputed fuel surcharge on the next electricity bill.	A + 36 days
As of 31st May, 2023			A + 42 days

Annexure 6

Timeline for Sudal Industries Limited

Sl.	Date	Event	Timeline
1	17th July, 2020	A section 7 application is filed by Canara Bank	NA
2	9th December, 2020	A section 7 application is filed by Jaldhara Properties and Trading Private Limited	NA
3	4th September, 2022	Filing of PPIRP application	Date of filing (F)
4	6th October, 2022	Registration of PPIRP application	32 days
5	12th October, 2022	The Counsels petitioned Court-I, NCLT Mumbai, to move before the Principal Bench of NCLT, New Delhi, for transfer of the petition to NCLT Mumbai, Court-IV, where related matters were pending. The Tribunal granted liberty to take necessary steps and listed the matter for 2nd December, 2022.	38 days
6	2nd December, 2022	Due to paucity of time, NCLT Mumbai, Court-I listed the matter for 6th February, 2023.	89 days
7	5th January, 2023	NCLT Principal Bench, New Delhi transferred both, the pending section 7 petition and the section 54A petition to NCLT Mumbai, Court-IV.	123 days
8	23rd January, 2023	NCLT Mumbai, Court-IV listed the matter for hearing on 7th February, 2023.	141 days
9	7th February, 2023	Counsel for the respondent sought and was given two weeks to file a reply.	156 days
10	3rd March, 2023	As requested by the Counsel, the matter was listed for 16th March, 2023	180 days
11	16th March, 2023	The Tribunal noted the Counsels' appearance and listed the matter for hearing on 20th March, 2023	193 days
12	20th March, 2023	The Tribunal noted the Counsels' appearance and listed the matter for hearing on 24th March, 2023	197 days
13	24th March, 2023	Applicant's Counsel was directed to submit auditor report to verify the debt.	201 days

Sl.	Date	Event	Timeline
14	28th March, 2023	The Tribunal heard the Counsels and reserved the order.	205 days
15	19th April, 2023	The Tribunal deferred passing an order to the next day to pass a consolidated order in all three related matters.	227 days
16	20th April, 2023	The Tribunal admitted the PPIRP application and dismissed the one section 7 petition as not maintainable and dismissed the other section 7 petition as infructuous.	228 days Date of admission (A)
17	12th May, 2023	Report submitted by the RP certifying the constitution of the CoC was taken on record.	A + 22 days
As of 31st May, 2023			A + 41 days

Annexure 7

Timeline for Loon Land Developers Limited

Sl.	Date	Event	Timeline
1	15th October, 2021	Filing with the registry	Date of filing (F)
2	18th November, 2021	Registration by the registry after scrutiny	27 days
3	23rd November, 2021	The matter is listed for physical hearing at Counsel's request.	32 days
4	24th November, 2021	The Tribunal heard the matter and lists it for 29th November, 2021.	33 days
5	29th November, 2021	The Tribunal passed an order admitting the application to PPIRP.	38 days (Date of admission)
6	28th January, 2022	Status report filed by the RP was taken on record.	A + 60 days
7	23rd February, 2022	Matter adjourned as the Bench is operating as different bench.	A + 86 days
8	7th March, 2022	Matter was rescheduled to 9th March, 2022.	A + 98 days
9	9th March, 2022	Matter adjourned as the Bench is operating as different bench.	A + 100 days
10	11th March, 2022	Tribunal heard an IA which objected to the resolution plan. Tribunal sent a notice to the RP and lists the matter for 23rd March, 2022.	A + 102 days
11	23rd March, 2022	Matter was adjourned as the Bench is operating as different bench.	A + 114 days
12	30th March, 2022	At the requests of the Counsels, matter was listed for physical hearing on 20th April, 2022.	A + 121 days
13	20th April, 2022	Counsel for the objector withdrew IA which the Tribunal dismissed as withdrawn.	A + 142 days
14	21st April, 2022	Counsel for the RP sought time to prove the CD was a MSME. The Tribunal directed a copy of the order to be issued to the Ministry of MSME (MoMSME) and listed matter for physical hearing on 6th May, 2022	A + 143 days
15	6th May, 2022	Representative of the MoMSME sought more time to get inputs from senior officer with regards to the process of MSME registration.	A + 158 days

Sl.	Date	Event	Timeline
16	30th May, 2022	Matter was adjourned due to paucity of time	A + 182 days
17	22nd July, 2022	At request of Counsel, matter was listed for physical hearing on 25th July, 2022.	A + 235 days
18	25th July, 2022	At request of Counsel, matter was listed for 3rd August, 2022.	A + 238 days
19	3rd August, 2022	Matter adjourned due to paucity of time. In the meantime, the Tribunal directed pleadings to be completed and hard copies to be filed by the date of next hearing.	A + 247 days
20	2nd September, 2022	At request of Counsel, matter was listed for 30th September, 2022.	A + 277 days
21	30th September, 2022	At request of Counsel, matter was listed for 14th November, 2022.	A + 305 days
21	14th November, 2022	At request of Counsel who sought more time to argue the matter, the matter was listed for 23rd January, 2023	A + 350 days
23	23rd January, 2023	At request of RP, one week was given by the Tribunal for answering the question whether the CD was a MSME.	A + 420 days
24	17th February, 2023	The Tribunal, on the applicant's request, dismissed the petition as withdrawn.	A + 445 days

[1] Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process, Ministry of Corporate Affairs, October, 2020, pp. 2.

[2] *Ibid.*, pp. 31.

[3] *Ibid.*, pp. 32.

[4] *Ibid.*, pp. 36.

[5] The Pre-pack Committee cautioned '*that limiting pre-pack either for MSMEs or non-MSMEs would require determination of the status of a CD at the admission stage, which could be an additional burden on the limited capacity of the AA*" but also conceded that *"[a]t the same time, making pre-pack available for all CDs, without commensurate capacity augmentation of the AA, could result in process delays*'.

[6] Vide notification dated June 26, 2020, the classification is as follows:

- Micro companies: Investment in plant /machinery /equipment < ₹1 crore & turnover < ₹5 crore
- Small companies: Investment in plant /machinery /equipment < ₹10 crore & turnover < ₹50 crore
- Medium companies: Investment in plant /machinery /equipment < ₹50 crore & turnover < ₹250 crore.

[7] MCA Notification 1543(E) dated 9th April, 2021.

[8] Insolvency and Bankruptcy (Pre-Packaged Insolvency Resolution Process) Rules, 2021.

[9] *In re Amrit India Limited*, CP (IBPP) No. 03 (PB)/2022.

[10] *In re GCCL Infrastructure and Projects Limited*, CP(IB)/116(AHM)2021.

[11] *In re Enn Tee International Limited*, CP (IBPP) No. 01 (PB)/2022.

[12] *Shree Rajasthan Syntex v. State Bank of India*, CP No. (IBPP)- 01/54C/JPR/2022.

[13] *In re Sudal Industries Limited*, CP (IBPP) No. 01/MB-IV/2022.

[14] *In re Loon Land Developers Limited*, (IB)-(PP)-03(PB)-2021.

[15] *In re Krrish Realtech Private Limited*, (IB)-(PP)-02(ND)/2021.

[16] *In re CHD Developers Limited*, (IBPP)02(PB)/2022.

[17] NCLAT New Delhi, Company Appeal No. 1168 of 2022.

[18] NCLAT New Delhi, Company Appeal (AT) (Insolvency) Nos. 1008, 1009 & 1010 of 2021, Order dated 21st December, 2021.

[19] *In re Krrish Realtech Private Limited*, IA-5344/2021, INV 32/2021, INV 33/2021, INV 34/2021 and INV 35/2021.

[20] *In the matter of Krrish Realtech Private Limited*, 2021 SCC Online NCLAT 429.

[21] *Ibid.*, para 15, 18, 21.

[22] *Rajeev Kumar v. CHD Developers Limited*, (IB)-1081(PB)/2020 order dated 7th June, 2021; see para 36 of *In re CHD Developers Limited*, (IBPP)02(PB)/2022, Judgement dated 5th September, 2022; see NCLAT order dated 15th February, 2021, in Company Appeal (AT) (Insolvency) No.114 of 2021 w.r.t debt owed to OCs.

[23] NCLAT Company Appeal No. 1168 of 2022.

[24] The Tribunal distinguished the cases on the fact that in CHD Developers, '*the Corporate Debtor had consented to admission of Financial Creditor's application u/s 7 of the code prior to filing of application u/s 54C of the Code*' and that was not the case in Sudal Industries.

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[30] Interview with Mr. Ashwini Kumar Tewari, "The Resolution Professional", IIIPI, Vol. 3.2, (April, 2023), pp. 7.

16

Insolvency Issues in Indian Aviation Sector: Whether Pre-Insolvency Mechanism can Address the Issues?

- Mamata Biswal

INTRODUCTION

The Indian aviation sector was very progressive in last 20 years due to launch of new airlines like Indigo (2006), Go First (GoAir, 2005), Kingfisher Airlines (2003), Air Deccan (2003), Jet Airways (1993), Spice Jet (2004-2005, originally started in 1983). Earlier the Air India was the oldest dominated airlines which started its operation in 1932 as Tata airlines and is currently under the control of the Tata group after the acquisition. Vistara Airlines started its operation in 2015 by Tata Sons Pvt. Ltd. in joint venture with Singapore Airlines Ltd. The Kingfisher Airlines was established in 2003 under the parent company United Breweries Group company and started its commercial operation in 2005 and had second largest shares in Indian domestic air travel market. Though the company has already started accumulating losses, but after the deal with Air Deccan, the financial position declined due to huge losses and its net worth eroded. Finally, the company became bankrupt. The employee's dues were ₹ 300 crore. Air Deccan airlines, which started its operations in 2003 became the low-cost airline. It was also deeply embroiled in losses and could not survive and was acquired by the Kingfisher by 2008. In case of Jet Airways (1993), the airline was considered as one of the best airlines and was equated with the tagline of 'joy of flying'. The airline was operative in nearly 1000 national and international routes before its insolvency. SpiceJet had started its business in 1983 in providing private air taxi services, then as MG Express in 1993 and finally as Spice Jet in 2004-2005. Recently, a petition has been filed against SpiceJet under the IBC for insolvency resolution. The airlines in India grew very fast and were bankrupted also.

ROOT CAUSE OF INSOLVENCY IN AVIATION SECTOR AND THEIR RESCUE

The root cause of the insolvency and bankruptcy of aviation sector varies from case to case. In India, different reasons behind the bankruptcy of different airlines can be seen. A common reason in three out of five insolvent airlines are unpaid lease dues.

Based on an empirical analysis[1] with the help of secondary data recovered from the annual reports of the company, a study highlighted the factors contributing to financial bankruptcy of Virgin Australia from 2012-2019. This study depicts 15 indicators which led to bankruptcy by the horizontal and vertical analysis from 2012-19. The research analyses horizontally, the Consolidated Statement of Comprehensive Income and Consolidated Statement of Financial Position of the company with the objective of an assessment of the increase or decrease in each item's value in the preceding financial year. The Vertical analysis has been done with the objective of analysing consolidated income statement of Virgin Australia from 2012-19 using the Consolidated Statement of

Comprehensive Income and Consolidated Statement of Financial Position. The research concluded with the findings that company's net income after taxes went negative since the companies' net expenses were on rise consistently; furthermore the utilization of company's profitability ratio and liquidity ratio was also in negative. The article further highlights that the indicators were visible and clear enough since 2012 for the company to act upon, and pandemic only made the situation adverse to be reverted. The research concluded with the finding that it was not entirely COVID-19 as a factor leading to insolvency in the company; there were several other factors which contributed towards the same.

To understand different factors leading to bankruptcy of Turkish airlines, the authors have divided the study[2] into three parts providing for development of Turkish Airlines in three intervals, pre-1983, 1983-2003 and finally post 2003; followed by the major factors contributing to the bankruptcy of these airlines. It is highlighted that 34 companies were launched between 1983 to 2003 of which 28 were bankrupt before 2000 followed by launching of 13 companies after 2000 and were shut down as well. From period of 1983-2013, 46 aviation companies were declared bankrupt. Upon analysis, the research laid down several factors like financial distress, lack of demand, increase in competition, high costs, etc. which led to bankruptcy of these airlines. However, the most important factor leading to bankruptcy is existence of financial difficulty within the company leading to substantial struggle in carrying out operations.

In a case study of three airline insolvencies in Europe, the author[3] has attempted to discuss the efforts made by different member states of Europe to handle three airline insolvencies i.e. Alitalia, Air Berlin and Monarch, in different ways due to which it affects the competition and further establishing a sound and well-functioning aviation market. The insolvency proceedings for each airline is highlighted, for e.g. Italian normative framework for airline insolvency, Article 17 under German Bankruptcy Code and Insolvency Act, 1986. The research highlights that in case of Alitalia insolvency proceedings, a high level of intervention was noticed by the State and the primary role was played by Commissioners; in case of Air Berlin proceedings, the insolvency court proceedings were mostly driven by court and hence lower probability of ambiguity and arbitrariness was found and lastly, in the case of insolvency proceedings of Monarch Airlines, high level of state intervention was found along with certain end of the airline. The article suggests for implementation of internationally coordinated legal framework on account of reason that airlines have inherently international character. Lina Forero[4] has discussed the various factors responsible for downfall of Mexicana Airlines in 2010, insolvency proceedings under Mexican Law of Bankruptcy along with Chapter 15 of US Bankruptcy Code. The contributing factors for the collapse of the Mexicana Airlines operations were higher cost of jet fuel, existing recession at global level, labour costs and lastly, the swine flu spread-out in 2009. The appointment of Mediator was made by Mexican Government Agency, The Communications and Transportation Ministry and later Mexicana adopted a restructuring plan prepared by PC Capital (a prospective buyer of Mexicana) in its conciliation stage. The takeover was failed due to insufficiency of funds with PC Capital. The Law of Commercial Bankruptcy (LCB) provides that Mediator would apply for another 90-day extension. In the latter case, a temporary preventive order had been passed by the court to protect the assets of the airlines, which forbidden a consortium of US airports to terminate contracts. After filing Mexicana's plea under Chapter 15 of US Bankruptcy Code, Mexicana's assets were protected from the creditors' claim. In the opinion of the author, most financially viable choice with Mexicana remained, the sale of the airline. Acquisition of brand and routes was preferred as a profit for the purchasing airline and also supported Mexicana to continue its operations under ownership and management of other airlines.

Steppler and other authors[5] in their article have emphasized on the different regulatory mediums of protecting passengers from airline insolvency situations like the situation during insolvency of Cimber Sterling. It is highlighted that the current regime for protection of consumers in case of insolvency is insufficient. Specific legislation, Montreal Convention (MC 99) are the initial point of analysing probable measures to protect the passengers which provides for compensation/ damages to passengers in case of delay. Similar provisions have been provided under European Legal Framework Regulation 261/2004, under Article 5 and 8 and under Directive 90/334/EEC. They have dealt with the problems with the existing territorial approaches which might surface in a situation where a ticket has been booked outside EU and the EU passengers would resultantly pay more for their tickets that non-EU passengers. They propose for the establishment of general reserve fund which can be utilized to reimburse or at least assist the stranded passengers and compulsory insolvency insurance individually for every air carrier as a solution in the existing framework. Dissanaike and other authors[6] have discussed an interesting question, i.e. 'why unsuccessful companies survive with a special focus on airline industry'? It is highlighted that during 2000-2008 the airline industry has suffered a cumulative loss of around $60 billion but no airline company has filed for insolvency resolution or no attempt was made for restructuring and take over. Interestingly, the role played by General Electric (GE) in aiding and supporting distressed airlines and interventions by GE led to avoid the inefficiencies under Chapter 11 of the Code; activities related to financing of airlines by GE like providing loans and leasing to airlines resulted in decreasing the risk of aircraft lessors. A large amount of market was also acquired by GE due to exclusive lease financing of the air carriers. However, the effect of the Great Financial Crisis in 2008 on GE ended the financing of airlines and the dependency on GE and later the most financially viable option considered in the airline company was consolidation, reallocation of controls between management and finally elimination of excess capacity without liquidation. Corporate governance is one of the important factor for financial distress.

CAPE TOWN CONVENTION AND PROTOCOL BILL

There is an opinion that the legislation in the line of the Cape Town Convention and Protocol would be a viable option as the convention proposes international electronic interest registration system. India is a party to this Convention since 2008. The Convention provides five categories of interests i.e. international interest, prospective international interest, national interest, non-consensual rights or interests arising out of National Law and registrable non-consensual rights or interests arising out of National Law.[7] 'It will benefit the security and interest being held by the sellers of aviation assets. Also the worldwide contract enforcement delay will reduce from 10 months to two months after the adoption of this Convention as per an estimation based on World Bank data'.[8]

Broadly the Cape Town Convention and Protocol provides the provision for requirements for creation of interest, default remedies, remedies for conditional seller or lessor, procedure, derogation, supervisory authority for establishment of the international registry, registration requirement, declaration about relief pending final decision, reservation and declaration etc. Cape Town Convention guarantees that in case of default in payment, the lessor gets repossession right in leased high value equipment like aircraft, engines and helicopter. There was a proposed draft bill in India and the Government is planning to expedite the legislative process of the Cape Town Convention Bill to provide comfort to the foreign aircrafts lessors.[9] This Bill if becomes a law will provide the comfort to the aircraft lessors in repossession of the aircraft in case of default in payment, which may not resolve the insolvency issue in the Indian context. In the same line, there is a provision in the US Bankruptcy Code i.e., section 1110 for the aviation sector. The lessor to the lease agreement will have right of possession of aircraft or any other contractual rights. *'The primary aim of the Convention and Protocol is to resolve the problem of obtaining certain and opposable rights to high value aviation assets, namely airframes, aircraft engines and helicopters which by nature have no fixed location'.*[10] There are 86 contracting states and Niger, Iraq and Cyprus have become party to the Convention in 2023.[11]

INSOLVENCY ISSUES IN INDIAN AVIATION SECTOR

While examining the insolvency issues with Indian aviation sector, it is observed that the reasons of shut down of Air Deccan and Kingfisher airlines are due to fuel price hike, low airfare etc. The current insolvency issue with the Go First and Spice Jet is due to the lessor and lessee dispute.

In case of Jet Airways bankruptcy, the increasing losses were observed in 2018. The aircrafts were grounded due to non-payment of lease dues. In almost all the insolvent and bankrupt airlines of India, the duration of active operation is 14 to 16 years. One of the pertinent question is raised, 'what can be the reason behind this common time duration to become insolvent?' Even after the initiation of the insolvency resolution process, they face many issues to rescue and to be operational.

Jet Airways insolvency resolution

In the matter of Jet Airways insolvency resolution, one petition was filed by the State Bank of India under section 7 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and another two petitions were filed by Gaggar Enterprises Pvt. Ltd. and Shaman Wheels Pvt. Ltd. as operational creditors (OCs) under section 9 of the IBC to initiate corporate insolvency resolution process (CIRP) against the Jet Airways. The National Company Law Tribunal (NCLT) admitted the petition filed by SBI under section 7 and passed the order for initiation of CIRP. The other two petitions filed under section 9 became infructuous and dismissed.

By that time the insolvency proceeding was already initiated against the corporate debtor (CD) in Noord Holland District Court and the court had passed the order for resolution process. To resolve the cross-border insolvency issues, a cross-border insolvency protocol was signed for the cooperation in the insolvency proceedings with the object of value maximization. With the direction of the National Company Law Appellate Tribunal (NCLAT), the protocol was agreed between the Resolution Professional (RP) of the company in India and the Administrator of the insolvency proceeding in Netherland. Finally, a property i.e. one of the Boeing 777 aircraft which was under the custody of the Dutch Administrator was sold as per the protocol to utilise for closing of the insolvency proceeding.[12] The Jet Airways has already informed to the stock exchange as required under the SEBI (Listing Obligations and disclosure Requirements) Regulations.[13]

Whether a separate petition can be filed for initiation of CIRP against a common CD in two different countries?

There was one issue related to the parallel insolvency proceedings in India and Netherlands. In *Jet Airways (Offshore Regional Hub Through the*

Administrator, Mr. Rocco Muldar) v. State Bank of India,[14] the NCLAT held that in the parallel insolvency proceedings of Jet Airways, the Dutch Trustee (Administrator) would work with the Indian RP. The 'Cross-Border Insolvency Protocol' was made final and would be treated as the direction of the NCLAT to be followed along with other procedural requirements under the IBC. Also, the Administrator (Dutch Trustee) is equivalent to the RP of Indian proceedings and can attend the committee of creditor (CoC) meetings without any voting rights.

Issues in Jet Airways for implementation of the resolution plan arose after the resolution plan was approved. In the consortium of *Mr. Murali Lal Jalan and MR Florida Fritsch v. State Bank of India and others (State Bank of India v. Jet Airways India Ltd.),*[15] the implementation application and exclusion application were filed on behalf of the successful resolution applicants of Jet Airways India Ltd. (Mr. Murali Lal Jalan and MR Florida Fritsch) with the prayer for implementation of the plan and execution of certain documents. The resolution plan of Jet Airways was approved on June 22, 2021. The respondents State Bank of India, Yes Bank Ltd., Punjab National Bank are the top three lenders of Jet Airways. The obligation of the successful applicant was to recommence the operation of Jet Airways after fulfilling certain conditions precedents like-

- Validation of air operation certificate by Directorate General of Civil Aviation (DGCA) and Ministry of Civil Aviation (MoCA)
- Submission of business plan to DGCA and MOCA
- Slots allotment approvals
- International Traffic Rights Clearance
- Approval of demerger of ground handling business into AGSL

The time plan was as follows:

In the resolution plan, the completion of the above conditions was mentioned as effective date. Also, these conditions need to be fulfilled within 90 days from the approval date which could be extended to a maximum period of 270 days. As a part of the plan, within 180 days from the effective date, the successful resolution applicant was required to infuse funds and to make payments to the stakeholders including employees, workmen and other OCs.

Infusion of fund and payment - Closing date was mentioned as the 180th day from the effective date or any earlier date, if the first tranche of ₹ 175 crore payment is made to the financial creditors (FCs). After that the entire management of the CD would transfer to the successful resolution applicants after dissolving the Monitoring Committee.

The resolution applicants have fulfilled few condition precedents and could not complete some condition precedents within the stipulated time. The fulfilment of the condition precedents was with other authorities. Finally, the NCLT granted the exclusion for a period of 180 days in the interest of justice and for the achievement of the objective of the value maximisation, and the date of execution of plan was extended till May 15, 2023. Interlocutory applications were filed by the State Bank of India and other lenders[16] praying for permission to appoint the Board of Directors for the fulfilments of some regulatory actions, for a stay of the operation of the order (NCLT), to vest the power of control and management of the CD with the RP, remand of the resolution plan to the CoC for fresh consideration and any other directions. The NCLAT approved the request for composition of the Board of Directors of the CD, reiterated the effort of the lenders and the successful resolution applicant for revival of the CD and also stated that the lenders can't invoke the performance bank guarantee without the leave of the Adjudicating Authority.

On the basis of the above discussion, the issues hindering the CIRP can be seen. In this case the order for initiation of CIRP was passed on June 20, 2019 but the plan could not be executed until June, 2023. The passengers, employees, workmen and other stakeholders are negatively affected during these four years.

The Indian Aviation sector has some different challenges comparing to other sectors. Specifically, the role of aircraft lessor is very crucial for the airlines and subsequent disputes between the Aircraft Company and lessor many a times, result in initiation of insolvency resolution process. That has happened with, Go Fast (GoAir) and recently with Spice Jet during the last five years. Many issues have been raised in the CIRP of Jet Airways and Go Air airlines and have disrupted the system and the airline services including the inconvenience caused to the passengers and economic losses to the employees, suppliers, vendors, logistics and other service providers and many other stakeholders. At the same time, to make the CD operational, the resolution applicant faces numerous problems connected to legal and regulatory approvals at Indian and international level, like the validity of Air Operator Certificate to restart the operation. In case of listed entity, it is detrimental to the shareholders of the company. These are very general for a defaulter corporate entity, nonetheless, the aviation industry impacts utterly the passengers because of limited number of airlines in India.

Go Airlines insolvency resolution

In the matter of Go Airlines Ltd.,[17] the application was filed by the corporate applicant i.e. Go Airlines Ltd. under section 10 of the IBC for initiation of CIRP. The applicant had stated that it had started default in payment towards the vendors, aircraft lessors, also had received the notice for repayment from the creditors DAE (Ireland) Limited, SMBC

Aviation capital, GALMSN etc. As per the application, the applicant had committed default of ₹ 2660 crore towards the aircraft lessors and ₹ 1202 crore towards the vendors. The applicant requested for an interim moratorium to preserve the assets of the company and to keep the company as a going concern. At this stage, some of the OCs wanted to object the application under section 65 of the IBC. Another objection made by the OC was that the creditors were not issued notice in providing an opportunity to object the main application.

The applicant has stated that the financial distress and default is due to the supply of defective engines supplied by Pratt and Whitney (P&W). Because of defective engines, the aircraft was grounded, and 34% of aircrafts were grounded in 2022. The dispute related to honour the contractual obligation could not be mitigated despite of the attempts made by the corporate applicant to resolve the issue. The applicant also brought to the notice of the NCLT that there was an arbitration award in favour of the applicant, but P&W did not comply with. The applicant also has initiated another enforcement proceeding against P&W in Delaware and other jurisdictions, where the engines were located. At, this stage, some OCs stated that they were willing to file an application under section 65 of the IBC. Very interesting questions were raised and discussed as under:

a) Whether the IBC mandates the issuance of notice to the creditors before admitting the application under section 10 of the IBC?

b) Whether the creditors can file a petition under section 65 after commencement of CIRP?

The NCLT did not find any ground to reject this. Finally, the application was admitted to initiate CIRP against Go Airline. In the matter of *SMBC Aviation Capital Ltd. v. Interim Resolution Professional of Go Airlines (India) Ltd.*,[18] four appeals were filed against the order of the NCLT admitting the application by the CD under section 10 with the following questions:

- Whether the creditors of a CD to be provided the opportunity of hearing before filing an application under section 10 of the IBC?
- Whether the objection made by the creditors (section 65) related to malicious intent of the CD in filing the application under section 10 to be decided before proceeding for the admission of the application under section 10 of the IBC?
- Whether the moratorium is applicable to the assets of the aircraft's lessors, who have terminated the lease agreement in favour of the CD, prior to the filing of application under section 10 of the IBC by the CD?
- Whether the lessor who has terminated the lease agreement in favour of the CD is entitled to claim the possession of the aircrafts

and export the aircrafts in accordance with the lease agreement after admission of application under section 10?

The NCLAT upheld the order of NCLT regarding admission of the application under section 10 and initiation of CIRP. The NCLT stated that the Interim Resolution Professional can approach the NCLT about the entitlement of lessor on assets under the lease agreement and applicability of the moratorium. Also, the NCLAT stated that the creditors can file separate petition under section 60 and also under section 65, .

Against Spice Jet, the aircraft lessor Will Lease Finance Corporation has filed an insolvency petition and the NCLT has questioned the maintainability of the petition filed by Wills. The lessor has already filed a petition earlier and also has withdrawn it in March, 2023. The argument of Wills is that they have obtained permission from the NCLT to withdraw and refile the petition. The NCLT has stated that matter needs more discussion, and the matter is listed in July, 2023.[19]

In the above three insolvency resolution matters, it is evident that the insolvency resolution in aviation sector affects the passengers, employees, workmen and other stakeholders. Also, the issues raised during the CIRP delays the process unnecessarily.

The author[20] while discussing the Thomas Cook collapse, has discussed that substantial reasons to choose liquidation not administration was due to funding of the insolvency, for e.g. claiming of pre-insolvency debts, payment towards third parties or suppliers of fuel, existence of liability of Administrator and airport charges etc. They suggested to introduce certain provisions in the legislation like, introduction of pre-insolvency moratorium clause which protects the company from creditors, but the management is still in operation; prevention of counter-parties from terminating contracts on the basis of declaration of insolvency; provision for financing for rescuing which will have priority over existing creditors. The reasons leading to collapse of Thomas Cook, are circled around rising debt on account of acquisitions and restructured negotiations involving Thomas Cook's bonds, banks and other stakeholders which existed since April of 2019.

CONCLUDING REMARKS

In India, there is a shortage of airlines to adequately cater to the needs of the passengers, and the number of airlines are less compared to other countries. The recent past shows the consecutive insolvency of three airlines in a span of less than five years. The issues related to aircraft lease contract between the Indian airlines with the foreign aircraft lessors is one of the concern among the others. The insolvency of one single airline disrupts the system and adversely affects the passengers, the employees and many other stakeholders associated with the business of the airline. In the said background, the issues in aviation sector needs to be addressed with appropriate modification in the legal framework and intervention of regulators. A 60 to 90 days period for mitigation of the dispute in pre-CIRP process may solve the purpose. Introduction of temporary deregistration mechanism for (2-3 months) prior to filing of insolvency petition may be helpful to mitigate the dispute related to default of non-payment and will be a pre-warning to the airlines. The intervention of the lessors of aircraft must be minimised and the airline should be facilitated to be operational. Almost all Indian airlines depend upon the aircraft lessors for aircraft leasing or leasing of engine of the aircraft etc. of foreign jurisdictions. In both SpiceJet and Go Air (Go First), the lessors have intervened. Addition of special protective provision like pre-insolvency moratorium clause in the IBC, may help the airlines to attempt for repayment of debt before filing of the application for CIRP. In an analysis of Turkish aviation industry, the author[21] has suggested for revision of legislative and regulatory measures, planning of financial management activities and finally ensuring implementation of transparent, fair and competitive governance for Turkish aviation industry. The MoCA has proposed a draft bill on Protection and Enforcement of the Interest in Aircraft Objects Bill, 2022 with the object of facilitating the aircraft leasing companies to transfer and repossess the aircrafts in case of disputes. The Government is planning to introduce the Bill in the monsoon session (2023) of the Parliament. According to the news,[22] the Bill will give primacy to the Cape Town Convention and the Code. But consideration should be given to the lessor's intervention during the CIRP. The current situation of two airlines under the CIRP and petition has been filed against Spice Jet, is a matter of grave concern. The remaining airlines may not be sufficient and efficient to cater the travel needs of the public. At the same time, the airlines should not be free from the debt liability. A pre-insolvency moratorium process for the recovery of debt from the CDs of aviation sector may avoid the issues in the process of insolvency resolution. Also, the pre-packaged insolvency resolution process can be extended to the aviation sector to address the issues.

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17

Going Concern Sale under Liquidation: Antithesis to Resolution

- Ansh Gupta and Ajanta Gupta

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) provides a market mechanism for rescuing failing but viable corporate debtors (CDs) and liquidating failing and unviable CDs. The Hon'ble National Company Law Appellate Tribunal (NCLAT), in the matter of *Binani Industries Limited v. Bank of Baroda & Anr.*, clarified the objectives of the Code as: '*The first order objective is "resolution". The second order objective is "maximisation of value of assets of the Corporate Debtor" and the third order objective is "promoting entrepreneurship, availability of credit and balancing the interests". This order of objective is sacrosanct.*'

It is to be noted that the Preamble to the Code makes no mention at all of the liquidation, which is only used as a last resort if there is no resolution plan or the resolution plan filed is rejected. Thus, when the resolution fails, the Adjudicating Authority (AA) commences the liquidation process wherein the assets of the CD are to be liquidated. It is the duty of the Liquidator to sell all the movable, immovable, and actionable claims of the CD subject to relinquishment of security interest by the creditor. However, the Liquidator can carry the business of the CD for its beneficial liquidation if he considers it necessary. Section 33 further clarifies that the order for liquidation shall be deemed to be a notice of discharge to the officers, employees, and workmen of the CD. Furthermore, section 54 of the Code mandates for dissolution of the CD, post the assets of the CD have been completely liquidated. On the contrary, the resolution process under the Code aims to rescue the distressed CD in a time-bound manner and maintain the CD as a going concern status. Thus, the Code demarcates the two different processes, i.e., resolution and liquidation, with their underlying objectives and stages. Accordingly, distinct provisions for the resolution process and liquidation process have been envisioned, which are run by different professionals, i.e., Resolution Professional (RP) and Liquidator, with distinctive roles. However, over the time dealing with purposes, interpretations, and gaps under the Code, the liquidation process has overlapped with the spirit of the resolution process by enabling the CD to sell as a going concern.

SALE AS A GOING CONCERN INTRODUCED UNDER LIQUIDATION REGULATIONS

Regulation 32 of the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations), as originally notified on December 15, 2016, *inter alia*, provided for the sale of assets of CD in a slump sale (i.e. selling one or more undertaking in lump sum consideration). In the matter of *Gujarat NRE Coke Limited*, while relying on the provision relating to the slump sale of assets of CD, the Hon'ble National Company Law Tribunal (NCLT), vide order January 11, 2018, had directed that the Liquidator shall try to dispose of the CD as a going concern. Remarkably, the AA directed the Liquidator to keep the reserve price for selling the CD as a going concern equal to total debts, including interest, and try such a sale for a period of 90 days. Failing which, the assets would be sold as per the provisions of Liquidation Regulations. Considering the above, Liquidation Regulations was amended on March 27, 2018, and one more option under the sale of assets in Regulation 32 was added as '*the corporate debtor as a going concern*' with no stipulation of a manner of keeping the reserve price and maximum time limit.

Thereafter, the term 'going concern' was studied, which talked about the continuous operating of business activity as a whole or a part of the business of the CD, and accordingly, another option was added under the sale of assets as '*the business(es) of the corporate debtor as a going concern*' in October, 2018. Pertinent to mention that during such amendments, there were deliberations for accommodating to sell the CD as a going concern during liquidation. Like, the CD will survive in case of selling the CD as a going concern under liquidation, so section 54 of the Code which deals with dissolution of the CD post liquidating the assets, would not be required. The ownership shall be transferred by the Liquidator to the acquirer. The assets, along with all attendant claims, limitations, licenses, permits, or business authorizations, will remain in the CD. It was envisaged that the Liquidator shall make an application to the AA for approval of the sale of the CD as a going concern, and the AA may pass an order with respect to (a) Sale of the CD to the intended buyer as a going concern (b) Transfer of shares of the CD to the intended buyer (c) Transfer of the going concern of the CD to the buyers (d) Continuation of the authority, powers, and obligations of the Liquidator to complete the liquidation process as provided under the Code and the regulations including the control, operations, and continuation of the liquidation bank account of the CD, (e) Payment to stakeholders in accordance with section 53 from the liquidation bank account, and (f) Protection of the intended buyer from all claims and liabilities pertaining to the period prior to the sale of the CD as a going concern. Then again, nothing was provided under Liquidation Regulations to deal with such issues.

The first thought that emerges is - Whether such prompt reaction to AA's decision was emergently required despite the fact that there is no mandate under the Code? Couldn't that decision be left as case specific? However, such amendments were justified on the grounds that many cases were falling under liquidation, and it was necessary to revive such companies. Nevertheless, it was also recognised that there are legacy cases that led to an increase in the number of liquidation cases. Considering this, the second thought is - Why efforts were not made to reinstate the corporate insolvency resolution process (CIRP) of the CD which had the potential to survive, where the committee of creditors

(CoC) is still active to revive the CD as a going concern? How come the overlapping of the liquidation process with the prime objective of resolution was not identified?

The journey of going concern sale under liquidation goes on, and in a plethora of cases, the Courts have directed the Liquidator to make endeavours to dispose of the CD by selling it on a going concern basis during liquidation.

FACILITATING SALE AS A GOING CONCERN DURING LIQUIDATION

In July, 2019, significant amendments were then made to facilitate the sale as a going concern during liquidation. The role of the CoC was defined under the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) by inserting new Regulation 39C. It was provided that the CoC, while approving a resolution plan or deciding to liquidate the CD, may recommend the Liquidator to first explore a sale of the CD/business as a going concern during the liquidation process. Further, the CoC, in its commercial wisdom, would identify and group the assets and liabilities to be sold of the CD/business as a going concern. RP shall place these recommendations before the AA. Consequentially, corresponding changes were made in the Liquidation Regulations. It was also added that in case the CoC has not identified the assets and liabilities under regulation 39C of the CIRP Regulations, it shall be the duty of the Liquidator to identify and group the assets and liabilities to be sold as a going concern in consultation with the stakeholder's consultation committee. It is necessary to understand the effect of identifying the liabilities to be sold as a going concern. It may lead to a different waterfall mechanism in case of a sale of going concern as the liabilities which have been kept aside would be treated as per section 53 of the Code. Nevertheless, the problem was much bigger, i.e., granting of reliefs, waivers, and concessions for operationalising the sale as a going concern under the liquidation process.

RELIEFS, WAIVERS, AND CONCESSIONS FOR GOING CONCERN– NOT ENVISAGED UNDER LIQUIDATION

In the matter of *Maxx Mobile Communication Limited*, the Liquidator filed an application before AA, *inter alia*, seeking a grant of comprehensive reliefs, waivers, and concessions on behalf of the acquirer. AA vide its order dated January 21, 2021, while dismissing the said application as withdrawn, has stated that '*It is made clear that if the Auction Purchaser confronts any problem with any Authority in respect of the sale of the Company as a going concern by the Liquidator, it would be at liberty to approach this Tribunal for redressal*'.

In the matter of *Enviiro Bulkk Handling Systems Pvt. Ltd.*, the successful bidders/applicant in the auction sale of the CD under liquidation as a going concern, prayed before NCLT Mumbai Bench, *inter alia*, for approval of sale of the CD as a going concern and sought consequential reliefs for resumption and restructuring of the CD and for the statutory compliances, subsequent to the auction sale, as they are administrative in nature. The Liquidator had submitted before AA that the e-auction process was successfully completed, and the entire bid amount had been paid. With respect to the consequential reliefs, the Liquidator has submitted that AA, in its discretion, has the power to grant such reliefs, and unless the said reliefs are granted, the CD cannot function as a going concern, and the revival and working of the CD as a going concern will be adversely affected post its release from the liquidation. AA, in its order dated June 21, 2021, observed that since the Liquidator has already accepted the bid and the auction sale of the CD as a going concern is completed, no specific order or ratification of the sale is required. The action of the Liquidator is in accordance with the relevant provisions of the Code, and consequences thereof would follow according to law and *inter alia* allowed the following reliefs to the successful bidder: (a) The successful bidders are permitted to restructure the Capital account; (b) The Liquidator shall distribute the sale proceeds as per section 53 of the Code; (c) The existing share capital of the CD shall stand extinguished; (d) The Registrar of Companies (RoC) concerned is directed to show the status of the CD as 'Active' from 'Liquidation' in their records; and (e) The successful bidders are at liberty to reconstitute the Board of Directors as per provisions of the Companies Act, 2013, and the appropriate filings may be affected before the RoC concerned.

In the matter of *M/s Viswa Infrastructures Finance & Services Pvt. Ltd.*, pursuant to the order dated January 18, 2021, passed by NCLT, Hyderabad Bench wherein the Liquidator was permitted to sell the CD as a going concern in accordance with Regulation 32(e) read with 32A of the Liquidation Regulations, the Liquidator filed an application before the NCLT to grant necessary reliefs for the successful bidder to kick start the business and follow the law laid down under the Companies Act, 2013. The AA, in its order dated June 30, 2021, observed:

> Since the decision to sell the Corporate Debtor as a going concern is taken by the Liquidator in consultation with the creditors / stakeholders and the proceeds from the sale of assets are going to be utilized for distribution to the creditors in the manner specified under section 53 of the Code, all the creditors of the Corporate Debtor get discharged and the assets are transferred free of any encumbrances. We are of considered view that it is a fit case to grant certain reliefs in favour of the purchaser

The AA *inter alia*, allowed the following: (a) The successful bidder shall get all the rights, titles, and interests over the whole and every part of the CD. The assets specified in the e-auction memorandum, on payment of the consideration, shall vest with the successful bidder; and (b) The Liquidator is directed to ensure the completion of pending filings with the RoC and any other Government/Statutory Authorities and to provide all support and assistance to the successful bidder for the smooth functioning of the CD to complete the acquisition.

Thus, the reliefs, waivers, and concessions for limitations, licenses, permits, or business authorizations, which are designed for resolving the CD during the resolution plan, are now being sought for selling the CD as a going concern during the liquidation. There is no explicit provision under the Code like section 31 for resolution, as there was no legislative intent to grant such reliefs/concessions/waivers during liquidation. So, no regulation has been provided, and need-based grants are being approved by AA for sale as a going concern under liquidation. Hence, this regime is uncertain and varies from case to case.

RECOMMENDATIONS OF ILC AND STANDING COMMITTEE OF FINANCE

The Insolvency Law Committee (ILC) deliberated whether a going concern sale of the CD should be permissible during liquidation. Its February, 2020 Report mentioned that the Code only allows for an entrance into liquidation in cases where the CIRP fails. Liquidation is therefore defined as the '*state the entity enters at the conclusion of an IRP, where neither creditors nor debtors can find a generally agreeable solution by which to keep the entity as a going concern*'. Therefore, the CD's inability to continue as a going concern is implied by the fact that it has entered liquidation. As a result, the Code mandates that the CD be dissolved at the end of the liquidation procedure. The Committee further noted that attempts to revive a company after an opinion for liquidation was issued by the Board for Industrial and Financial Reconstruction or winding up was ordered under the Companies Act, 1956, was considered a source of value destructive delays. The Committee noted that if attempts to revive the CD are undertaken after a liquidation order is passed, it may lead to delays and may also undermine the efficacy of CIRP, which provides a time-bound period for reviving the CD. For this purpose, section 11(d) of the Code prohibits a CD undergoing liquidation from re-initiating CIRP. The Committee decided that allowing a CD to be sold as a going concern after its liquidation process, which calls for the dissolution of the corporate entity, would be contrary to the scheme of the Code. However, the Liquidator may try to do the same if the CD's business can be sold as a going concern. Therefore, the Liquidation Regulations should be adequately modified to stop the sale of the CD as a going business.

The Standing Committee on Finance (2020-21), in its 32nd Report titled 'Implementation of Insolvency and Bankruptcy Code - Pitfalls and Solutions' noted that the NCLT, Principal Bench in the matter of *Invest Asset Securitisation & Reconstruction Pvt. Ltd. v. Mohan Gems & Jewels Pvt. Ltd.* has also a taken the view that liquidation requires dissolution under the IBC and hence regulations that provide for liquidation as a going concern are *ultra-vires* and that the legislation has created further uncertainty. Thus, it recommended that regulation 32(e) of Liquidation Regulation which provides for sale as a going concern, be deleted. However, where the business of the CD can be sold as a going concern, the Liquidator may attempt the same.

Further, the Colloquium on Functioning and Strengthening of the IBC Ecosystem, in its Report of November, 2022, has also recommended deleting the provision of sale as a going concern under liquidation and advocated for part sale during resolution resulting in cost and time efficiency in early closure of the process.

OUTCOMES OF SALE AS A GOING CONCERN UNDER LIQUIDATION

As per data available with regard to dissolution/closure of matters under IBC, it is observed that till now 30 CDs have been sold as a going concern under IBC, as presented in Table below:

Table 1: Sale as Going Concern Cases

(₹ in crore)

Sl.	Name of the Corporate Person	Liquidation Commencement Date	Date of Order Dissolution / Closure	Amount of Total Admitted Claim	Liquidation Value during CIRP	Liquidation Value during Liquidation	Realised Value	Amount Distributed to Stakeholders	Time Taken	% of Sale proceeds to Admitted claims#
1	Emmanuel Engineering Private Limited	04.07.18	24.06.19	7.80	6.35	4.62	5.93	5.21	355	76%
2	Parerhat Gas Industries Limited	08.08.18	12.05.23	228.53	1.99	2.37	2.83	2.59	1738	1%
3	Sri Vinayaka Paper and Boards Limited	26.11.18	28.03.23	413.63	84.37	60.43	46.47	43.1	1218	11%
4	Sri Gangadhara Steels Limited	11.12.18	30.09.22	174.12	13.52	14.18	14.88	13.14	1389	9%
5	Servomax India Private Limited	04.02.19	07.02.22	794.15	91.70	30.96	53.17	48.15	1099	7%
6	Enviiro Bulkk Handling Systems Private Limited	27.03.19	21.06.21	147.23	13.45	14.21	15.30	14.12	817	10%
7	Su-Kam Power Systems Limited	03.04.19	11.05.22	1067.19	148.50	51.36	50.25	15.08	1134	5%

8	K.T.C. Foods Private Limited	31.05.19	18.05.20	151.78	18.45	18.46	18.46	16.86	353	12%
9	Autodecor Private Limited	04.06.19	16.11.21	126.10	15.09	15.09	15.53	13.63	896	12%
10	Smaat India Private Limited	06.06.19	13.08.20	63.90	4.64	2.72	5.49	4.75	434	9%
11	DC Industrial Plant Services Private Limited	19.06.19	19.04.22	368.35	52.59	30.73	41.40	38.13	1035	11%
12	Maadurga Thermal Power Company Limited	25.06.19	07.11.22	805.45	42.78	77	59.69	50.19	1231	7%
13	Southern Online Bio Technologies Limited	16.07.19	22.06.20	513.05	34.23	34.23	51.70	49.07	342	10%
14	Winwind Power Energy Private Limited	08.08.19	08.02.21	856.77	79.70	78.00	64.28	61.62	550	8%
15	Turbo Machinery Engineering Industries Limited	06.11.19	17.06.22	722.98	5.08*	5.08	7.58	5.79	954	1%
16	Chincholi Sugar & Bio Industries Limited	19.12.19	23.06.22	676.48	43.97*	43.97	37.46	35.08	917	6%
17	Konark Power Project Limited	20.12.19	23.01.23	31.3	6.72	6.72	7.05	6.33	1130	23%
18	Tulsi Extrusions Limited	20.02.20	01.05.23	596.22	28.93	28.94	19.90	17.09	1166	3%
19	Bhaskar Shrachi Alloys Ltd	29.04.20	23.03.22	196.3	7.29	7.29	11.12	9.72	693	6%
20	Topworth Pipes & Tubes Private Limited	12.06.20	09.03.21	2,731.82	182.00	152.00	190.90	186.78	270	7%
21	I.C.S.A. (India) Limited	18.08.20	07.02.23	4743.53	21.11	6.91	11.04	10.24	903	0%

22	PD Advisory Services LLP	04.09.20	11.07.22	2.67	0.10*	0.10	0.11	-	675	4%
23	Mehta & Associates Fire Protection Systems Private Limited	12.02.21	03.03.23	6.80	1.17 *	1.17	1.47	1.35	749	22%
24	Visa international Limited	11.05.21	03.03.22	8143.17	22.37	8.82	9.02	8.38	296	0%
25	Nazar International Pvt. Ltd.	20.07.21	13.01.22	42.76	5.50	4.88	5.5	5.08	177	13%
26	Raipur Polymers Private Limited	10.08.21	14.12.21	8.74	0.98*	0.98	1.39	1.22	126	16%
27	Terra Energy Limited	17.02.22	18.01.23	549.36	39.99	27.65	23.05	21.9	335	4%
28	KRR Infra Projects Private Limited	22.03.22	10.03.23	344.93	2.37*	2.37	2.68	2.19	353	1%
29	Chadalavada Infratech Limited	11.04.22	06.06.23	440.48	1.08*	1.08	1.08	0.46	421	0%
30	Sasi Power Private Limited	13.04.22	03.02.23	11.92	1.78	4.96	3.73	2.88	296	31%
	Total			**24,967.52**	**977.79**	**737.27**	**778.46**	**690.13**	**735**	**3.12%**

Notes:

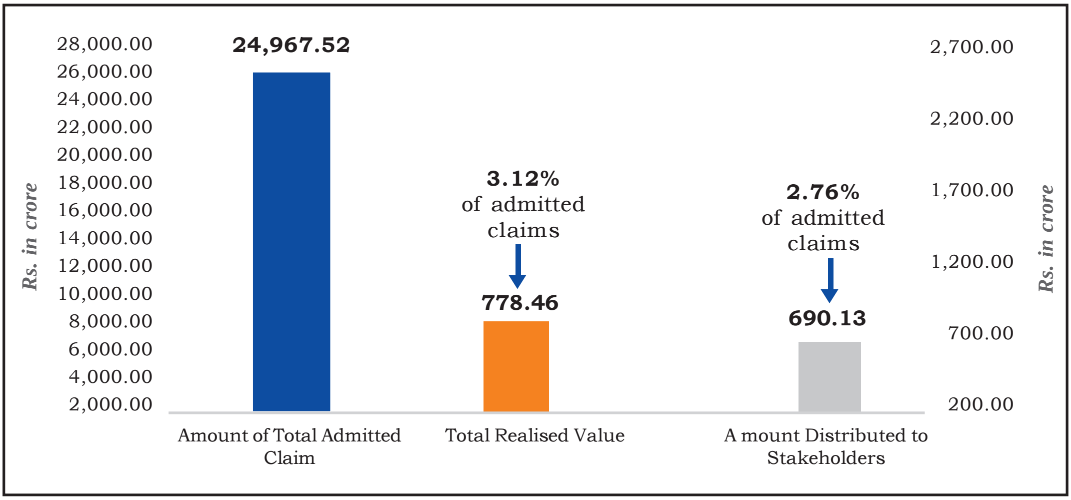
#Numbers are rounded off

*Due to non-availability of liquidation value during CIRP, liquidation value during liquidation has been assumed as liquidation value during CIRP.

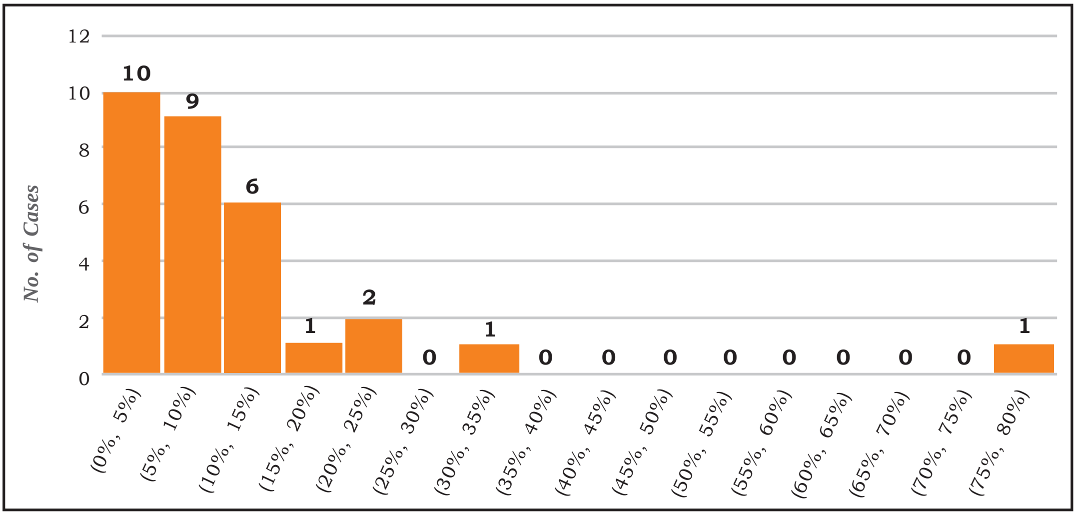
Based on availability of data and strictly for research purpose only.

The study shows that the 30 CDs sold as a going concern under liquidation yielded ₹ 778.46 crore, which is 3.12% of the total admitted claims of ₹ 24,968 crore. Out of ₹ 778.46 crore, the amount distributed to stakeholders is ₹ 690.13 crore, resulting in 2.76% of total admitted claims (Graph-1). The stakeholders have received 71% of the liquidation value during CIRP and 94% of the liquidation value during liquidation. Thus, the liquidation value has fallen by roughly 25% from the CIRP period to the liquidation period. Further, the Graph-2 shows that 19 CDs out of 30 CDs have sale proceeds within the range of 10% of total admitted claims, and seven more CDs have sale proceeds up to 20%. With regard to the time taken to sell the CD as a going concern, it is found that no CD was sold within 90 days. Moreover, 735 days on average, were taken for selling as a going concern under liquidation. It is further noted that 15 CDs took more than two years to close.

Graph-1: Outcome of 30 CDs sold as going concern under liquidation

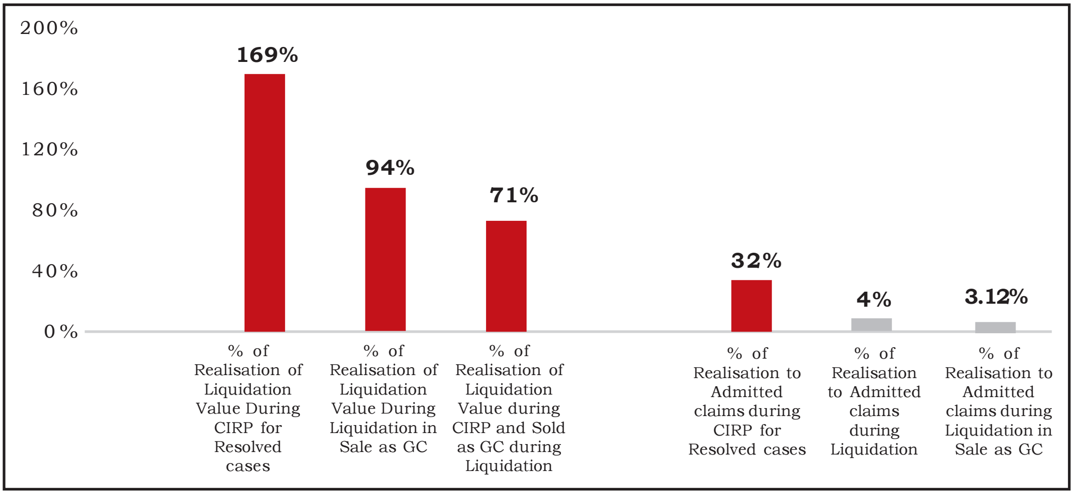


Graph-2: Percentage of sale proceeds to admitted claims



On comparison of outcomes of resolution during CIRP and sale as a going concern during liquidation, the study shows that total realisation to admitted claims is 32% during resolution *(678 Resolutions; Source: Quarterly Newsletter of IBBI – Jan-March 2023)* while it is only 3.12% in case of sale of going concern during liquidation (which is below than approx. 4% realisation during liquidation in a normal mode of sale of assets) as shown in Graph 3 below. Further, realisation to liquidation value of resolved cases during CIRP is around 169% *(678 Resolutions; Source: Quarterly Newsletter of IBBI – Jan-March 2023)*. However, for sale as a going concern during liquidation, realisation is 94% of liquidation value during liquidation and 71% of liquidation value during CIRP. Thus, there is an almost 100% lower realization of liquidation value while selling as a going concern during liquidation (71%) compared to resolution (169%).

Graph-3: Comparative Study - Realisation % during CIRP for resolution and sale as going concern during liquidation



KEY CONCERN- DISCLOSURE OF RESERVE PRICE DURING LIQUIDATION PROCESS

The significant difference in *modus operandi* of the sale of assets under liquidation and revival of the CD under resolution are disclosure of reserve price and reduction of reserve price thereof for liquidation sales. The reserve price is the minimum price set by the Liquidator in consultation with stakeholders below which the asset cannot be sold. It is intended to protect the interests of the creditors and ensure that the assets are not undersold. According to Schedule I of the Liquidation Regulations, the reserve price for the sale shall be determined in line with the valuation determined under regulation 35 and set by taking the average of the two Registered Valuers' values. However, during the CIRP, the reserve price/liquidation value is not disclosed to the prospective resolution applicant (PRA) in the information memorandum (IM). Thus, the resolution applicant accesses the value of the CD through his own resources. The theory behind eliminating the necessity of including the liquidation value in the IM was that upon access to such value, PRAs were more inclined to offer bids closer to the liquidation value rather than the value on a going-concern basis.

Allowing the sale as a going concern during the liquidation process with disclosure of reserve price is entirely reversed to the approach adopted under the resolution process. Additionally, the reduction of the reserve price, 25% initially and 10% thereon, as allowed under Schedule I of Liquidation Regulations, is far-fetched and inconceivable during the resolution process.

It may be noted that the liquidation value of the assets of the CDs as a whole is being reduced by 10%-25% at each successive auction round while selling them as a going concern. However, a substantial value is derived from assets, such as land and building, which do not lose the value of such magnitude within such a short span of time, let alone the possibility of their market value appreciating over time. For an instance, in the matter of *Sembmarine Kakinada Limited*, the entire CD as a going concern was first auctioned at ₹236.69 crore on January 12, 2022. On failure, it was re-auction as a going concern at ₹213.02 crore on January 20, 2022 and ₹191.72 crore on January 28, 2022 by successively reducing the reserve price by 10%. Similarly, the IVRCL was first auctioned as a going concern at ₹1600 crore reserve price, and later on, the reserve price was reduced by 25% and sold for ₹1200 crore. In *ABG Shipyard*, the first reserve price was kept at ₹1480 crore for composite assets and then reduced to ₹1332 crore, ₹1200 crore and ₹1104 crore on subsequent auctions.

To control the above, the Regulator, in September, 2022, amended 90 days period for selling the CD as a going concern to exclusively sell the CD as a going concern at the first auction only. Interestingly, the Regulator initially mandated that sale as a going concern, either CD or business, cannot be more than 90 days. Despite the term 'shall' used, the timeline remains a directory in nature. Thus, the sale of CDs as a going concern took more than three years, as viewed in Table 1. However, the primary concern is the recent amendment, which uses the term 'may' for the Liquidator to sell the CD as a going concern exclusively only at the first auction. Hence, the same is not mandatory.

In the matter of *Nolsar International Limited* under liquidation, AA vide its order dated February 8, 2023 ruled that there is no prohibition on selling the CD as a going concern in subsequent auctions, even if the Liquidator may only sell the CD's assets at the first auction. AA, based on a joint reading of regulation 32A(4) and regulation 32(e) of Liquidation Regulations, concluded that the Liquidator is free to conduct a subsequent auction of the CD as a going concern without seeking permission from the Tribunal.

Further, the timeline for selling the business as a going concern has now been eliminated. Thereby, the reserve price for selling the business can now be reduced 'N' number of times. Need to mention that the value can be recomputed during liquidation, so even for selling the CD as a going concern at the first auction; there can be a substantial reduction of value resulting in lowered reserve price. In nutshell, the entire procedure of selling the CD/business as a going concern during liquidation is an antithesis to resolution.

SUMMING UP

In view of forgoing discussion, it is asserted that two mechanisms have been rolled out for one goal 'reviving the CD as a going concern' but with different nomenclature i.e. resolution of the CD under the resolution process and selling the CD as a going concern under the liquidation process and notably, with significantly diverse rules. The Code and original regulation 32 of the Liquidation Regulations did not contemplate the sale of the CD as a going concern during the liquidation process. The judicial intervention and regulatory undue interference have coined and introduced the concept of the sale as a going concern during liquidation under IBC, contrary to its legislative intent. Afterward, Insolvency and Bankruptcy Board of India, the Regulator, made further amendments in the CIRP and Liquidation Regulations to facilitate the sale of CD as a going concern under liquidation. Accordingly, the CoC, at the end of the CIRP period, may recommend the CD to sell as a going concern during liquidation. Ironically, if the CD is viable, why was the resolution not reattempted despite this being the essence of the Code?

The study shows that there is a very low realisation value of 3.12% against the total admitted claims in case of the sale of a going concern during liquidation compared to 32% in resolution during CIRP. In a normal mode of sales, the lump sum realisation to admitted claims during liquidation is around 4%. Therefore, even if assets are not sold as a going concern, the yield remains constant, and practically, there has been no value addition for selling the CD as a going concern; rather the liquidation value during liquidation was hammered down by 25% from the CIRP period. Moreover, the clubbing of liabilities along with the assets for a sale of CD as a going concern, arbitrary grant of reliefs/waivers/concessions, disclosure of reserve price while auctioning the CD as a going concern, and the reduction of the reserve price by 25% on the first attempt and 10% subsequently are provisions conceptually conflicting to resolution. Notably, reduction of reserve price for sale as a going concern at one go disturbs the resolution process (as PRA would wait for liquidation to buy the CD via backdoor entry) while adversely affecting the value maximisation during liquidation by directly reducing the reserve price of valuable assets, like land and building, bundled in reserve price of CD/business as a going concern.

One of the earliest mentions of 'sale as a going concern' is found under the winding up of the Companies Act, 1956. Remarkably, there was no resolution process in that regime for a revival of the viable CD. In this regard, the ILC committee in 2020 has acknowledged the inefficiency of 'sale as a going concern' under winding up as value destructive delays.

Additionally, it viewed the sale of the CD as a going concern during liquidation is contrary to the scheme of the Code. Further, the Standing Committee on Finance had recommended to delete the sale as a going concern during liquidation and allow part sale during resolution for maximising the value of the assets of the CD. The same view was endorsed by the Colloquium held on Functioning and Strengthening of the IBC Ecosystem in November, 2022. Despite the recommendations of the ILC Committee and the Standing Committee on Finance, the selling the CD as a going concern during liquidation was worked upon rather than facilitating sale of assets during resolution and prospect of 32% of realisation during CIRP as compared to 4% during liquidation, was ignored. Keeping in view of objectives of the Code i.e., resolution and value maximisation, 'selling the business as a going concern' should also have been promoted during resolution under regulation 37 of the CIRP Regulations which allows transfer/sale of part of assets of the CD to two or more persons.

To conclude, over-regulation against the legislative intent is not only *ultra vires* but also does more harm than good.

WAY FORWARD

It is the duty of the Regulator to make regulations in line with the objectives of the Code and to carry out its provisions. Needless to say, the IBC's prime objective is resolution. Thus, instead of dragging viable CDs into liquidation, a re-attempt should be made to resolve them during the CIRP. The AA, on recommendations by the CoC, may permit to reinstate the CIRP from the stage of inviting fresh/matching bids from the remaining resolution applicants. Further, to expedite the resolution process and eliminate uncertainties and ambiguities, fair value may be provided to PRAs for resolving the CD. Not least of all, looking at meagre realisation of 3.12% and re-computation of liquidation value during liquidation process leading to 25% drop in value and further reduction of reserve price, the CoC should be given full voice as a decision-making body rather than consultative role to streamline the liquidation process.

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Liquidity in Distressed Assets Market: Recent Reforms and the Road Ahead

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INTRODUCTION

A critical feature of a robust economy is its ability to resolve stress in the market and especially so during times of economic slowdown. High levels of non-performing loans (NPLs) in the market locks in capital that could otherwise support fresh funding. This can have adverse implications in emerging markets, where credit is mostly provided by banks.[1] In this effort, the creation of a lucrative market for private credit, enabling market participation in the secondary market by a wide investor-base and fostering investment opportunities in stressed assets hold significance. To facilitate this endeavor in turn requires a sound legal and regulatory framework.

The Indian economy has witnessed its fair share of economic crises, such as the non-performing asset (NPA) crisis faced by public sector banks (PSBs), that stemmed from market concentration, inadequate governance norms, the lack of a developed secondary market to absorb stress, the lack of special situations players to resolve stress and a strong private credit market to inject liquidity. Recent trends suggest a decline in gross NPA ratio to a 7-year low of 5% and net NPA ratio to a 10-year low of 1.3% amongst PSBs in the country,[2] owing to amongst other things, the measures adopted by the government to promote private credit. While the scale of the credit market in India is growing, the secondary market has not risen in consonance with the market size and remains small compared to other Asian markets such as Malaysia, South Korea and China.[3]

With this backdrop, this article attempts to analyse the entry routes available for investments in the Indian distressed assets market and the way forward to create an amicable environment to encourage private credit in the country.

ENTRY ROUTES FOR FOREIGN INVESTMENT IN THE INDIAN DISTRESSED ASSETS MARKET

Foreign portfolio investor route

Indian regulations permit a foreign fund to register as a 'foreign portfolio investor' (FPI) with the securities market regulator Securities and Exchange Board of India (SEBI); and such FPIs are permitted by SEBI and the central bank, Reserve Bank of India (RBI), to invest in specified securities, each of which are dealt with in this article:

- Security receipts (SRs) issued by asset reconstruction trusts;
- Non-convertible debentures;
- Securitised debt instruments;

- Equity instruments issued by non-performing borrowers;
- debt instruments issued by banks;
- credit enhanced bonds;
- derivatives; and
- other instruments that may be permitted by the RBI.[4]

Notably, while the extant regulations allow FPIs to invest in debt securities, they are not permitted to lend or purchase loans. Further, FPI investments in debt instruments are subject to macro-prudential restrictions as follows:

(a) **Minimum residual maturity:** FPIs may invest only in corporate bonds with a minimum residual maturity of one year, subject to such short-term investments (with residual maturity of less than one year) not exceeding 30% of the total investment of that FPI in corporate bonds;

(b) **Concentration limits:** The RBI from time-to-time fixes the maximum permissible limit for FPI participation in debt instruments issued by corporates. In case of long-term FPIs, their investments cannot exceed 15% of the prevailing investment limit for corporate debt instruments and for other FPIs their investment cannot exceed 10% of the investment limit; and

(c) **Investor-level limit:** FPIs (including their related FPIs) cannot invest more than 50% of any single corporate bond issuance.[5]

FPIs may thus tap into the Indian distressed assets market through investments in the following securities:

(i) **SRs and debt instruments issued by Asset Reconstruction Companies:**

Introduction

- The primary investment route for investors to acquire distressed assets in India is through the Asset Reconstruction Companies (ARCs) route, which is regulated in terms of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) and regulations issued by the RBI.
- ARCs that are registered with the RBI are permitted to engage in the business of asset reconstruction and acquire financial assets of any bank or financial institution. This would include acquisition of any loan or advance, debentures or bonds, guarantees, letters of credit or any other credit facility extended by such bank or financial institution.[6]

- ARCs may, after acquiring financial assets, offer SRs to qualified institutional buyers and the proceeds from the realization of financial assets shall be used to redeem the SRs. The ARC may formulate a scheme for issuance of SRs by setting up a trust in accordance with the Indian Trusts Act, 1882 and SARFAESI (Securitisation Trust), which shall be managed by the ARC. The ARC shall hold the assets or funds acquired pursuant to the issuance of SRs in trust for the holders of SRs.[7]

- The ARC shall invest in the SRs issued by them at a minimum of least 15% of the transferors' investment in the SRs or 2.5% of the total SRs issued, whichever is higher.[8]

- FPIs may invest up to 100% of each SR tranche issued by an ARC that is available for investment after deduction of the minimum subscription requirement for the ARC (as above).

- Neither the investor-level limit of investment up to 50% of the corporate bond issue-size nor the minimum residual maturity requirement would be applicable on FPI investment in such instruments issued by ARCs. [9]

Acquisition of NPLs by ARCs

- In the context of debt instruments under default, the RBI (Transfer of Loan Exposures) Directions, 2021 (Transfer of Loan Exposure Directions) permit ARCs to acquire loan exposures of lenders that are classified as NPAs or as special mention accounts (Stressed Loans), including loan exposures classified as fraud, through assignment or novation. Such Stressed Loans may be acquired from lenders such as scheduled commercial banks and non-banking finance companies.[10]

- Where the aggregate exposure in the loans being transferred exceeds ₹100 crore (i.e. around USD 12 Million), negotiations between the transferors and the transferee must necessarily be followed by an auction through 'Swiss Challenge' method, provided that an acquisition of loans pursuant to the RBI (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 (RBI Prudential Framework Directions) is mandatorily followed by a Swiss Challenge auction irrespective of the auction size.

- The RBI has revamped the regulatory framework for ARCs vide circular dated October 11, 2022 (RBI Revised ARC Framework). Notably, ARCs have been permitted to submit resolution plans for corporate debtors (CDs) undergoing corporate insolvency resolution process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) as a resolution applicant, subject to the ARCs having a net-owned fund requirement of ₹ 1,000 crore, making adequate disclosures in their financial statement regarding their exposure to assets acquired under IBC and having set up an internal control mechanism including a board of directors approved policy for the ARC to undertake the role of a resolution applicant. Further, ARCs are not permitted to retain any significant influence or control over the CDs after five years from the date of approval of their resolution plan by the Adjudicating Authority under IBC. Any non-compliance with this condition would entail ARCs from being barred from submitting fresh resolution plans under IBC until such non-compliance is cured.

Limitations posed by this route

Under the present structure, FPIs are dependent on ARCs to effectively invest in the stressed loans market, and this limits their participation, due to the following reasons, as noted by the RBI Task Force in its Report on the Development of Secondary Market for Corporate Loans, 2019 (Task Force Report):[11]

- There are a limited number of ARCs in the market who have the necessary skill, capital and expertise to acquire and restructure NPAs due to which they dominate the market. In these cases, it is tough for new investors to break into the market if the ARCs already have exclusive business relations with the existing FPIs.
- Since FPIs require ARC participation, they are dependent on the ARC agreeing with their risk appetite and investment strategy which may be difficult, and which effectively gives the ARC a 'veto' on the choice of asset or the method of restructuring.
- Further, since FPIs cannot directly purchase NPLs, they are forced to participate through the ARCs which in the end limits FPI's options to the number of ARCs which are active even if there is a higher number of FPIs which want to take part.
- ARCs tend to have more control over the process since they serve as the medium for the transaction and are mandated by law to have skin in the game, thereby preventing the FPIs from effectively leading the transaction.
- ARCs are required to invest a minimum amount in the acquisition price to ensure skin in the game, but capital availability acts as a constraint thereby restricting the number of transactions.
- Even if majority of the capital (85%) is invested by the FPIs, ARCs charge fees which could have gone to Indian lenders as part of their recoveries.

(ii) **Non-convertible debentures or corporate bonds in default:** FPIs are permitted to invest in non-convertible debentures and/or corporate bonds which have a principal repayment or principal instalment payment default (either in part or full). The investor-level limit of investment up to 50% of the corporate bond issue-size and minimum residual maturity requirement are not applicable on such investments.[12]

(iii) **Debt instruments issued pursuant to CIRP under IBC:** FPIs are permitted to invest in debt instruments issued by CDs undergoing CIRP. Neither the investor-level limit of investment up to 50% of the corporate bond issue-size nor any minimum residual maturity requirement would be applicable on FPI investment in such instruments.[13]

(iv) **Securitised debt instruments:** FPIs are also permitted to invest in securitised debt instruments, including any certificate or instrument issued by a special purpose vehicle set up for securitisation of assets with banks and financial institutions as regulators.[14]

(v) **Equity investment in distressed entities:** FPIs may invest in equity of entities under distress subject to sectoral caps and restrictions under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

Conclusion

Data released by the RBI shows an increase in FPI investment in SRs issued by ARCs from around ₹10,000 crore to ₹14,482 crore during the financial year 2021-2022.[15] Despite the efforts to boost access to foreign credit, the regulatory ambiguities are causing hurdles for investors to invest in Indian distressed assets. Further, while FPIs are permitted to transact in debt securities, they are presently not permitted to issue or purchase loans, which constitutes a major asset class in the Indian distressed asset market.

Alternative investment funds route

Introduction

Alternative investment funds (AIFs) are privately pooled investment vehicles established, registered with and regulated by SEBI. Until 2022, AIFs were only permitted to invest in debt securities (such as bonds and debentures), securitised debt instruments[16] and SRs.[17] They were restricted from acquiring loans directly thereby limiting the potential of AIF as an entry route for foreign capital investment in distressed assets. Further, AIFs are subjected to diversification limits wherein they can only invest up to 25% of their investable fund in an investee company.[18]

Special situations funds

SEBI in its board meeting on December 28, 2021 proposed to amend the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) to introduce a new sub-category of AIFs for investment in stressed assets – Special Situation Fund (SSF). These amendments were subsequently notified on January 24, 2022 and were accompanied by a circular dated January 27, 2022[19] which provided further guidelines on the SSFs.

SSFs have been introduced as Category I AIFs and are permitted to (a) invest only in 'special situation assets' in accordance with its investment objectives and/ or (b) act as a resolution applicant under the IBC.[20] 'Special situation assets' have been defined under the AIF Regulations to include:

- **Stressed Loans**

  For SSFs to acquire stressed loans, they have to be included as a permitted transferee under the Transfer of Loan Exposure Directions[21] – the inclusion is still awaited from the RBI and presently this route is not available to SSFs.

  Paragraph 58 of the Transfer of Loan Exposure Directions contemplates comprehensive resolution of all the INR loans of a stressed borrower held by the Indian banks / financial institutions wherein there is an exit of all lenders to the stressed loan exposure. Therefore, acquisition of individual debt of a corporate entity is not permitted under this route. Further, stressed loans, acquired under paragraph 58 are subject to a minimum lock-in period of six months. However, this lock-in period is not applicable in the event of recovery of the stressed loan from the borrower. In addition, SSFs also have to comply with the same initial and continuous due diligence requirements for their investors as are applicable to investors in ARCs.

  While AIFs have been permitted in the past to be resolution applicants under the IBC,[22] the relaxations provided to SSFs (for instance deletion of the diversification limits, which therefore allows SSFs to invest more that 25% of their investable fund in a CD), make them a more desirable option to be resolution applicants compared to other category of AIFs. SSFs intending to act resolution applicants under IBC also have to ensure compliance with the eligibility requirements provided under the IBC.

- **SRs issued by an ARC registered with the RBI**.

- **Securities of investee companies:**

  (a) whose stressed loans are available for acquisition under paragraph 58 of the Transfer of Loan Exposure Directions, or as part of a resolution plan under the IBC or acquisition under any other policy framed by the RBI or the Government of India in this regard;

(b) against whose borrowing, SRs have been issued by an ARC registered with the RBI;

(c) whose borrowings are subject to CIRP under Chapter II of the IBC;

(d) who have disclosed all the defaults relating to the payment of interest/ repayment of principal amount on loans from banks/ financial institutions/ systemically important non-deposit taking non-banking financial companies/ deposit taking non-banking financial companies and /or listed or unlisted debt securities in terms of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and such payment default is continuing for a period of at least 90 calendar days after the occurrence of such default;

In the cases of (c) and (d), there is a requirement for the credit rating of the financial instrument or credit instrument or the borrowings of the investee company to be downgraded to 'D' or equivalent.

Therefore, SSFs are restricted from investing in securities of companies which have not defaulted or have been in default for less than 90 days or whose credit rating is higher than a 'D'.

In addition to this, the pre-condition of having a credit rating may cause an impediment to SSFs investing in unlisted debt securities since they typically do not have a rating and it may be challenging to get the investee company to obtain a credit rating.

- **Any other asset specified by SEBI from time to time:**

  An SSF is restricted from investing in its associates, units of any other AIF other than the units of an SSF or units of SSFs managed or sponsored by its manager, sponsor or associates of its manager or sponsor. Further, SSFs are not permitted to invest in securities of companies incorporated overseas.

External commercial borrowings route

RBI's Master Directions - External Commercial Borrowings (ECBs), Trade Credits and Structured Obligations (ECB Master Directions), lays down the framework for raising commercial loans by domestic entities from non-resident entities.[23] It prescribes requirements pertaining to eligible lenders and borrowers, end-use restrictions, minimum average maturity periods, all-in-cost ceiling, reporting obligations, among others, for loans available under the ECB route.

By a circular dated July 30, 2019,[24] the RBI introduced certain relaxations to the ECB framework and allowed sale/assignment of certain domestic INR distressed loans (i.e., rupee loans availed domestically by corporate borrowers for capital expenditure in the manufacturing and infrastructure sector, if classified as SMA-2 or NPA) to eligible ECB lenders.[25] However, the resulting ECB also needs to comply with all the all-in-cost ceiling, minimum average maturity period and all other relevant norms laid down in the ECB Master Directions.[26]

That said, this route is presently pending to be operationalized, in view of several key clarifications pending from the RBI. Importantly, the ECB Master Directions do not specify whether the all-in-cost ceiling on the resulting ECB is to be determined based on the principal amount of the loan or the purchase consideration (in cases where the loan may have been acquired by the ECB lender at a discount).

RECENT EFFORTS/PROPOSALS FOR DEVELOPING LIQUIDITY IN DISTRESSED ASSETS MARKETS

RBI Task Force on development of a secondary market for corporate loans - Recommendations

The Task Force Report recognized the need for a secondary market which would serve as a platform for specialized investors to buy large portions of a distressed borrower's debt with the intention of acquiring a controlling stake in the company or driving the insolvency process of the borrower. To increase liquidity in the secondary market for distressed loans, the Task Force put forth certain recommendations, key of which (in relation to NPLs) are set out below:

1. The securitisation trusts route may also be permitted for acquisition of NPAs by FPIs.

- The Task Force Report had recommended that FPIs be allowed to use securitisation trusts for acquisition of NPAs. The Task Force Report has also suggested that, in case FPIs are permitted to invest in NPAs *via* securitisation trusts, the exemptions and benefits granted to ARCs – specifically provisions enabling debt aggregation, may be extended to FPIs as well.

- In light of this recommendation, in January 2023, the RBI the RBI floated a discussion paper on the Securitisation of Stressed Assets Framework (SSAF), whereby non-performing and stressed assets may be securitised by entities other than ARCs by setting up a Special Purpose Entity (SPE).

- The discussion paper has sought comments from the public on key aspects, including with respect to categories of investors eligible to participate in the SSAF, implementation of a minimum retention ratio requirement, assets which should be brought under the purview of 'Stressed assets', engagement of an independent resolution manager (RM), enabling credit enhancement facilities and access to interim finance for achieving resolution of the stressed assets.[27]
- To keep true to the intent, it is critical that the following factors are kept in mind while devising this route:
  - ➢ this route should be open to such classes of investors who are eligible to invest in SRs issued by ARCs under SARFAESI and the 'eligible investors' under the ECB Master Directions, subject to applicable prudential norms, to enable participation of sophisticated investors with adequate experience and resources;
  - ➢ this route should be open for standard assets which are over 30 days or more in default (i.e. SMA-1 and SMA-2 category assets) without any limitation, as these assets already show signs of the stress;
  - ➢ stressed large corporate accounts (namely, large value loans above a certain aggregate threshold (e.g. ₹ 100 crore)) should be permitted to be securitised;
  - ➢ As a matter of overall approach, the regime for securitisation of large NPAs (under SSAF) should be aligned with the regime for securitisation of corporate loans to asset reconstruction companies (including in terms of (a) assets which may be securitised, (b) powers / measures for asset reconstruction, (c) no minimum retention requirement (MRR), etc.);
  - ➢ SSAF should not prescribe any MRR requirement;
  - ➢ SPEs should be permitted to raise interim finance (as opposed to the RM who would be taking such debt in their books of accounts) during the resolution process would serve as a fillip to enable efficient resolution of the stressed assets, and such interim finance should be supported by the cashflows from the underlying assets;
  - ➢ Further, enabling credit enhancement facilities for all tranches of securitisation notes would incentivize the adoption of the SSAF, provided that the terms of reset are settled between the parties at the inception of the transaction so that the investors are aware of the terms before investing.

- The RBI has been in receipt of public comments from various market participants in relation to the proposed guidelines. Formal regulations from the RBI are now awaited.

2. RBI may consider permitting single loan securitisation and allow MFs, PFs, AIFs, FPIs and Insurance Companies to participate in these securities.

3. FPI investors may be allowed to directly purchase distressed loans from banks within an annual prudential limits defined by RBI in consultation with Government of India.

4. ARCs may be permitted to act as debt arrangers and therefore be allowed to charge fees for such services.

5. The RBI *vide* circular dated July 30, 2019 has permitted banks to sell, through assignment, certain loans (availed domestically for capital expenditure in manufacturing and infrastructure sector if classified as SMA-2 or NPA, under any one time settlement with lenders) to eligible ECB lenders provided, the resultant external commercial borrowing complies with all-in-cost, minimum average maturity period and other relevant norms of the ECB framework. FPIs and ECB lenders may be permitted to purchase distressed loans directly from banks across sectors under this scheme. This will pave the way for additional turnaround financing by them.

6. Extant regulations on ARCs for facilitating effective restructuring and resolution of stressed assets should also be made available to FPIs investing in NPAs. Specifically, provisions applicable to enable aggregation of debt by ARCs and any exemptions under SEBI guidelines may be extended to FPIs as well.

7. A scheme similar to the Voluntary Retention Route (VRR) recently introduced by RBI to enable FPIs to invest in debt markets in India, may be envisaged. Broadly, investments through the Route are free of the macro-prudential and other regulatory norms applicable to FPI investments in debt markets, provided FPIs voluntarily commit to retain a required minimum percentage of their investments (75%) in India for a period of three years. It is understood from market participants that the VRR has created a much positive impact in the market and hence can be adopted in the case of secondary market for corporate loans.

Notably, these recommendations are yet to be implemented.

RECOMMENDATIONS AND WAY FORWARD

- **Widening the scope of FPI investment in debt:** The present regulatory regime permits FPI investment only in debt securities. As highlighted above, loans are the primary debt instrument in the

Indian secondary market. Thus, restricting FPI's from purchasing or issuing loans has restricted a major opportunity to infuse liquidity in the Indian market. FPIs should be permitted to purchase NPLs and loan accounts. Addressing this issue would require regulatory changes that will involve a joint effort from the Government of India to amend the Foreign Exchange Management (Debt Instruments) Regulations, 2019 as well as regulators such as SEBI and RBI to suitably amend the SEBI (Foreign Portfolio Investors) Regulations, 2019 and the macro-prudential norms on FPI investment in debt.

- **Operationalizing the SSAF route:** The RBI should issue guidelines permitting securitisation of NPLs, as also allowing the flexibilities we have summarized above.

- **Incentivizing the use of SSFs:** Based on review of all the AIFs registered with SEBI, the authors noted that only two SSFs have been set up so far – despite the amendments being introduced more than a year ago. To encourage more participants in this space, the RBI should, at the earliest, recognize SSFs as permitted transferees for the purposes of paragraph 58 of the Transfer of Loan Exposure Directions.

  SEBI may also consider relaxing the investment restrictions on SSFs and permit them to invest in stressed assets which have not been in default for 90 days or have a rating above D. This would widen the scope of investments which an SSF may undertake, thereby providing them with more business opportunities. SEBI is also pushing for recognition of SSFs as a 'secured creditor' under SARFAESI so that it may enjoy enforcements rights which are available to ARCs and help them in resolution of the stressed assets.[28]

- **Operationalizing ECB route for acquisition of INR NPLs:** While the RBI guidelines permit INR NPLs to be assigned to eligible ECB lenders, due to clarifications pending from the RBI, this route has not been operationalized since 2019. The RBI should issue the necessary directions and clarifications to operationalize this route.

  For instance, the ECB Master Directions are not clear on whether the all-in-cost ceiling rate on distressed loans acquired under a discount is to be calculated on the basis of the purchase consideration or the principal amount of the loans. An amendment of the ECB Master Directions to expressly clarify that the all-in-cost ceiling should be calculated based on the principal amount will provide commercial incentive to investors to purchase distressed loans through the ECB route.

  Currently the ECB Master Directions only permit sale/assignment of distressed loans availed for capital expenditure in the manufacturing and infrastructure sector. The RBI could also consider expanding the categories of distressed loans which are allowed to be transferred, to other sectors.

- Increase the range of participants permitted to acquire stressed loans. Consequently, RBI may consider extending enforcement rights under SARFAESI to other such permitted acquirers which would allow them to effectively resolve stressed assets.[29]
- The requirement of a minimum holding period be done away with in case of sale of stressed assets.[30]
- Granting of exemptions/benefits which are already available to ARCs to FPIs to encourage their participation in the secondary stressed loans market.[31]
- Presently, ARCs are only allowed to undertake securitisation, asset reconstruction and are allowed to be resolution applicants under IBC. The RBI may consider increasing the activities they are permitted to participate in, for example they may be allowed to be debt arrangers since they would be suited for the role, and this would also help address the lacuna in the Indian market for debt arrangers.[32]

CONCLUSION

In times of global economic downturn, reforms in the distressed asset market are key to usher in a new era for the Indian economy. Statistics indicate that despite sinking NPA levels, there is a corresponding increase in loan write-offs by banks,[33] which posits the requirement for efficient alternatives to deal with distressed debt. A legal regime that is conducive for foreign investment and private participation in distressed debt will not only provide such an alternative for banks but would also provide a fillip to liquidity in the credit market during times of economic slowdown. Addressing the concerns raised in this paper is paramount in bringing about much needed clarity in the legal regime governing distressed debt and widen the investment opportunities which will in turn foster private investment and develop the Indian secondary loan market.

[1] Joaquim Levy J. (2017), "Why distressed asset resolution is important to development finance", World Bank.
[2] RBI, Financial Stability Report, December, 2022.
[3] Sankar T. (2022), "Corporate Bond Markets in India – Challenges and Prospects", RBI Bulletin, September.
[4] Rule 10 of the Foreign Exchange Management (Non-Debt Instruments) Rules 2019, Schedule 1 Paragraph 1 of the Foreign Exchange Management (Debt Instruments) Regulations, 2019 and Regulation 20 of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations 2019.
[5] RBI Circular on Investment by Foreign Portfolio Investors (FPI) in Debt – Review (updated up to February 26, 2021).
[6] Section 5, SARFAESI Act.
[7] Section 7, SARFAESI Act.
[8] Paragraph 7, RBI Master Circular – Asset Reconstruction Companies, 3rd April, 2023.
[9] Supra Note 5.
[10] Master Direction – RBI (Transfer of Loan Exposures) Directions, 2021 (Updated as on December 05, 2022).
[11] RBI Report of the Task Force on the Development of Secondary Market for Corporate Loans, 3rd September, 2019.
[12] Supra Note 5.
[13] *Ibid.*
[14] Schedule 1 Para 1(A)(i), Foreign Exchange Management (Debt Instruments) Regulations. 2019.
[15] RBI Report on Trend and Progress of Banking in India 2021-2022, December 27, 2022.
[16] Definition of 'debt fund', AIF Regulations.
[17] RBI Notification DoR. FIN. No. 08/26.03.001/2020-2021 dated 10th March 10, 2021, Notification under Clause (U) of sub-section (1) of section 2 of SARFAESI Act.
[18] Regulation 15(c), AIF Regulations.
[19] Introduction of Special Situation Funds as a sub-category under Category I AIFs, Circular No.: SEBI/HO/IMD-I/DF6/P/CIR/2022/009, 27th January, 2022.
[20] Regulation 19M, AIF Regulations.
[21] Para 3, Introduction of Special Situation Funds as a sub-category under Category I AIFs, Circular No.: SEBI/HO/IMD-I/DF6/P/CIR/2022/009, 27th January, 2022.
[22] Different benches of the National Company Law Tribunals *(Kitply Industries and Anr v. IDBI Bank Limited* – Guwahati Bench, *Punjab National Bank v. M/s Amzen Machines (P) Ltd.* – New Delhi Bench) have approved resolution plans submitted by AIFs.
[23] The RBI Master Directions - External Commercial Borrowings, Trade Credits and Structured Obligations (updated as on September 30, 2022).
[24] RBI/2019-20/20, A.P. (DIR Series) Circular No. 04 dated 30th July, 2019.
[25] Under the ECB Master Directions, the lender must be from a FATF or IOSCO compliant country in order to qualify as an 'eligible ECB lender'.
[26] Para 10, Master Directions - External Commercial Borrowings, Trade Credits and Structured Obligations (updated as on September 30, 2022).
[27] RBI Discussion Paper on Securitisation of Stressed Assets Framework (SSAF).
[28] Resolution passed by the SEBI in its Board Meeting dated 28th December, 2021.
[29] Supra Note 11.
[30] *Ibid.*
[31] *Ibid.*
[32] *Ibid.*
[33] Supra Note 2.

Part V

Entering New Horizons

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Resolving the Insolvency of Corporate Groups: An Approach Paper for the IBC

- Shardul Shroff, Aishwarya Satija and Kritika Poddar

INTRODUCTION

With increasing globalisation of economic activity, the number of enterprise groups in trade and commerce have not only grown internationally but also domestically. On average, Indian listed companies have more than tripled the number of subsidiaries during the past 15 years. As of March, 2020, Indian listed companies in the NIFTY 50 index have an average number of approximately 50 subsidiaries/step-down subsidiaries. Further, out of approximately 4100 listed companies for whom data is readily available, there were 15 listed companies that have more than 100 subsidiaries including wholly owned subsidiaries and step-down subsidiaries, while a few of them had more than 200 subsidiaries.[1]

Although a company can operate on a standalone basis, carrying out business through corporate groups accords several benefits. Group companies can take advantages of economies of scale and scope, diversification of risks, creation of competitive advantages, efficiencies in resource allocation, centralised functions, less reliance on contract enforcement and easier access to internal capital. These factors make corporate groups crucial contributors to an economy through generation of employment, and cross-border transfer of technology and talent, in case of international group structures.[2]

While formation of corporate groups indisputably offers various advantages, complex group structures can raise several challenges, especially in an insolvency scenario. When members of 'corporate groups' become insolvent, various issues arise that are unique to 'group companies' such as those on account of close operational and financial interlinkages and interdependencies between the group companies, treatment of group companies as a single economic entity by creditors or inter-group transactions that tunnel value from one group to another and may need to be reversed or dealt with differently in insolvency. In such a scenario, dealing with the insolvency of group companies belonging to the same corporate group often leads to loss of group synergies, group disintegration and suboptimal outcomes for creditors, debtors and other stakeholders.[3] Thus, it is important that a transparent and predictable regime exists to ensure adequate and coordinated approaches to the insolvency of group members and treatment of the group as a whole, and that it facilitates, rather than hinders, the fast and efficient conduct of insolvency proceedings.

In this background, this paper first gives a bird's eye view of the leading international practices relating to insolvency of group companies; second discusses the need for a holistic framework for group insolvency under the Insolvency and Bankruptcy Code, 2016 (IBC/Code); third provides a summary of the legislative policy discussions on group insolvency in India, and finally highlights the key issues with the proposed framework on group insolvency emerging from these discussions along with proposed solutions.

LEADING INTERNATIONAL PRACTICE

While there are significant differences in the way different jurisdictions deal with the insolvency of group companies, a review of the global group insolvency landscape elucidates some commonalities. At the outset, the codification of laws on group insolvency is a recent phenomenon and it has taken most jurisdictions a long time to arrive at this stage.[4] For instance, the European Union came out with regulations that deal with group insolvency in 2015[5] even though discussions on this started as early as the mid-1990s.[6] Similarly, while considering the Model Law on Cross-Border Insolvency in the 1990s, the UNCITRAL noted group insolvency to be 'a stage too far',[7] and a model law dealing with group insolvency was adopted by UNCITRAL in July, 2019.[8] These delays in enacting a group insolvency framework indicate the sheer complexities involved in resolving the insolvency of groups.

Secondly, insolvency laws primarily provide three kinds of remedies to deal with group insolvency – procedural coordination, substantive consolidation, and rules to deal with perverse behaviour. Procedural coordination includes rules that are targeted at coordination of insolvency proceedings, without disregarding the separate legal personality of different group companies. When mechanisms for procedural coordination are employed, the assets and liabilities of each group member remain separate and distinct, '*thus preserving the integrity and identity of individual group members and the substantive rights of claimants*'.[9]

Substantive consolidation, on the other hand, permits the court to disregard the separate identity of each group member undergoing insolvency proceedings in appropriate circumstances and consolidate their assets and liabilities, treating them as though held and incurred by a single entity.[10] The assets are thus treated as if they were part of a single estate for the general benefit of all creditors of the consolidated group members. Notably, many jurisdictions like the European Union,[11] Germany,[12] etc. solely focus on procedural coordination remedies when dealing with group insolvency and do not legislate on substantive consolidation. Even in jurisdictions like the US,[13] New Zealand,[14] Australia,[15] etc., where substantive consolidation is provided for in statute or case law, it is considered an extraordinary remedy which is limited to exceptional cases. This is because such consolidation eliminates the benefit of asset partitioning as well as potentially results '*in unfair treatment of certain creditor constituencies*'[16] and in undermining the licensing, tax, and other regulatory reasons for forming separate enterprises within a group.[17]

Insolvency laws also provide certain rules that may be used to address perverse behaviour of group members. Such rules deal with inter-mingled assets of group members, which may be implemented without substantively consolidating such members. For instance, courts in some jurisdictions[18] have the power to subordinate the claims of intra-group creditors to the claims of unrelated creditors. Courts are also permitted to pass contribution orders requiring solvent entities in a group to contribute monies to insolvent entities in the group. Although few jurisdictions provide for contribution orders, where available, they are generally employed in liquidation proceedings based on considerations of justice and equity.[19] Additionally, extension of liability orders are also provided for in some jurisdictions whereby the liability of a group entity is extended to other group entities (usually to parent entities), mainly where the subsidiary has wrongfully traded, and the parent company has not mitigated the same.[20]

The approach of various insolvency laws globally differs significantly regarding the kind of remedies that are employed to deal with group insolvency issues and the manner in which such remedies are utilised. The authors have provided below a brief overview of the relevant legislative instruments and literature developed by the UNCITRAL to promote harmonious group insolvency laws on a global level. The following discussion is meant to provide a bird's eye view of the international best practices on dealing with insolvency of group enterprises.

UNITRAL Legislative Guide, Part 3: Treatment of Enterprise Groups in Insolvency

Part 3 of the UNCITRAL Legislative Guide on Insolvency Law dealing with 'Treatment of enterprise groups in insolvency' (UNCITRAL Guide) addressed treatment of enterprise groups in insolvency both nationally and internationally. In case of domestic group insolvency, the UNCITRAL Guide recommends, (a) joint application for commencement of insolvency proceedings with respect to two or more enterprise group members;[21] (b) procedural coordination mechanisms such as *inter alia* appointment of a single insolvency representative, establishment of a single creditor committee, coordination between the creditors' committee etc.[22] (c) substantive consolidation with respect to two or more enterprise group members in circumstances where the assets or liabilities of enterprise group members are substantially intermingled or where the enterprise group members are engaged in fraudulent activities.[23]

In case of international group insolvency, the UNCITRAL Guide recommends inclusion of provisions for (a) access to domestic courts for foreign representatives and creditors and recognition of foreign insolvency proceedings, if necessary;[24] (b) different forms of cooperation involving courts including *inter alia* direct communication between domestic courts with foreign courts and foreign representatives, coordination of hearing with a foreign court, coordination of the administration and supervision of the affairs of the enterprise group members subject to insolvency proceedings;[25] (c) insolvency representatives and other parties of interest to enter into cross-border insolvency agreements to facilitate coordination of the management of different proceedings. It also recommends that courts should be empowered to approve and implement such cross-border insolvency agreements.[26]

UNCITRAL Model Law on Enterprise Group Insolvency

The UNICTRAL Model Law on Enterprise Group Insolvency (MLEGI) originated from the inability of the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI) to deal insolvencies of corporate groups satisfactorily. Adopted by the UNCITRAL in 2019, the MLEGI focuses on domestic and international insolvency proceedings relating to multiple debtors that are members of the same enterprise group complementing the MLCBI and the UNCITRAL Guide. It defines 'enterprise group' as two or more enterprises that are interconnected by control or significant ownership.[27] While the text of the MLEGI provides for the definition of 'control',[28] it leaves the expression 'significant ownership' open for the enacting states to define per their domestic requirements.[29]

The MLEGI addresses the conduct and administration of insolvency proceedings relating to two or more enterprise group members, whether those proceedings are local proceedings commenced in the enacting State, foreign proceedings commenced in another State or proceedings have commenced in both States.[30] An overview of its key provisions is provided below.

a) Planning proceedings, group insolvency solution and group representative

Planning proceeding is an insolvency proceeding that is used to develop a 'group insolvency solution'[31] for the whole or part of an enterprise group and is the 'main' insolvency proceeding commenced in respect of an enterprise group member that is a necessary and integral participant in that solution.[32] The proceedings must also involve the participation of other group members and the appointment of a group representative[33] who represents the planning proceeding and attempts to develop and implement a group insolvency solution.[34] Multiple planning proceedings for different parts of the enterprise group may also be developed.[35]

The MLEGI also provides for cross-border recognition of a planning proceeding and group insolvency solution.[36] It further allows courts to grant reliefs, including approval of post-commencement finance arrangements to assist the development of the group insolvency solution[37] and also envisages voluntary participation of multiple group members irrespective of their solvency status in a planning proceeding for the purposes of coordinating a group insolvency solution for relevant enterprise group members.[38] However, typically reliefs cannot be granted in respect of solvent members unless insolvency proceedings have not been commenced against them to minimise the number of insolvency proceedings (in accordance with the MLEGI).[39]

b) Minimisation of non-main insolvency proceedings

The MLEGI attempts to minimize the commencement of non-main insolvency proceedings relating to enterprise group members participating in the planning proceeding. To do this, it allows an insolvency representative[40] to give an undertaking to treat claims of creditors who would have claimed in a non-main proceeding, the same in the main proceeding as they would have been treated in the non-main proceeding.[41] Such an undertaking may also be given to minimise main proceedings, but these are to be used in exceptional circumstances.[42]

c) Coordination and cooperation

The MLEGI provides for coordination and cooperation between courts, insolvency representatives and group representatives (where appointed), by way of coordination of hearings,[43] information sharing,[44] coordination in carrying out different activities, including administration such as marketing,[45] appointment of the same insolvency representative in different insolvency proceedings,[46] agreements for cooperation and coordination,[47] allowing participation in insolvency proceedings of other group members. This includes the right to appear and to be heard in the main proceeding, to make written submissions to the court on matters affecting the interests of that enterprise group member and to take part in negotiations to develop and implement a group insolvency solution, in cases where that is relevant.[48]

GROUP INSOLVENCY UNDER THE IBC

While the IBC does not contain a comprehensive framework to deal with the issues that arise in 'group insolvency' cases, some provisions within the Code may aid in dealing with different aspects of group insolvency. For instance, sections 60(2) and (3) require insolvency proceedings of a corporate debtor (CD) and its corporate guarantor to be dealt with by the same bench of the National Company Law Tribunal (NCLT). The IBC also prescribes longer look-back periods for related party avoidable transactions. Further, sections 18(1)(f) and 36 of the IBC give control of the shares of the subsidiary to the Resolution Professional (RP) and Liquidator of the parent company which may enable the RP to obtain information from solvent group entities easily.[49]

In the absence of a formal and comprehensive framework to deal with insolvency of group companies, case law has developed to fill the gaps. The trends from these case laws are summarized below:

a) **Substantive consolidation**: Jurisprudence developed indicates that substantive consolidation is the most popular form of 'group insolvency' remedy. The test to allow substantive consolidation has been laid down in *State Bank of India & Anr. v. Videocon Industries Limited & Ors.*,[50] (Videocon Case) wherein the NCLT Mumbai on a study of cases in the United Kingdom and United States of America, proposed a two-step test for substantive consolidation of 13 out of 15 companies of the 'Videocon Group'; firstly, carrying out an analysis of the following factors *vis-à-vis* each entity with respect to common control, common directors, common assets, common liabilities, inter-dependence, inter- lacing of finance, pooling of resources, co-existence for survival, intricate link of subsidiaries, inter-twined of accounts, inter-looping of debts, singleness of economics of units, common financial creditors (FCs), and common group of CDs and secondly, preliminarily assessing whether consolidation yields benefits to stakeholders by offsetting the harm if not consolidated.

This test has been applied in subsequent corporate insolvency resolution processes (CIRPs)[51] and has been approved by the National Company Law Appellate Tribunal (NCLAT) as well.[52] Legal understanding has progressed, indicating that consolidation is only considered in respect of entities that are undergoing CIRP and not others.[53] Nevertheless, there have been deviations in the approach in certain instances. Notably in *Punjab National Bank v. KSK Mahanadi Power Company Limited & Ors.*, [54] the prayer to substantively consolidate the CIRPs of three group companies was denied despite reference to the Videocon Case. The NCLT concluded that the concept of group insolvency was unknown to the IBC and that the Videocon Case did not involve the pursuit to consolidate CIRPs, but rather pertained to the joint hearing of company petitions against the CDs of the same group. Although the matter is currently under appeal before the NCLAT,[55] this view appears to be inconsistent with the Videocon case which concerned the '*consolidation' of insolvency processes of Videocon Group companies*'.[56]

b) **Procedural coordination:** Although less common than substantive consolidation, procedural coordination of the various types has been allowed in cases by enabling joint applications,[57] joint hearings/designation of a single court,[58] appointment of single RP,[59] coordination to have a single resolution plan,[60] and cooperation and coordination.[61] However, even where procedural coordination is not sought/ordered expressly, there are some cases where in practice, the committees of creditors (CoC) choose to appoint the same RP and conduct joint meetings for different debtors.[62]

c) **Other cases:** In addition to these, there are cases where subordination orders have been made[63] and separate legal personality has been disregarded in order to hold parent entities liable for debts of their subsidiaries.[64]

NEED FOR A HOLISTIC FRAMEWORK FOR GROUP INSOLVENCY UNDER THE IBC

In the absence of formal framework for the insolvency resolution and liquidation of group companies, the following practical issues have come up:

(a) Lack of nuanced application of group insolvency rules

Currently courts apply substantive consolidation to group companies without adequately considering the underlying nature of their respective businesses. This is despite the availability of abundant literature on the severity of substantive consolidation which indicates that the power to consolidate should be used sparingly and in exceptional circumstances.[65] While this equitable remedy allows the courts and tribunals to prevent fraudulent use of group corporate structures, it strikes age-old principles of corporate law by effectively piercing the corporate veil and disregarding the separate legal identity of each of the group companies. It also potentially threatens to prejudice the rights of creditors, as a creditor of a debtor whose asset to liability ratio is higher than that of its affiliated group company may end up receiving a smaller satisfaction of its claim since the asset-to-liability ratio in a consolidated estate will be lower.[66]

Further, when used in reorganization, substantive consolidation may undermine the licensing, tax and other regulatory reasons due to which the companies are organized as separate group companies.[67] Where there are different types of businesses, courts should permit 'deemed consolidation' where for the purposes of voting and distribution, the claims are consolidated as if the distinct entities were consolidated, but the reorganized corporate group retains its pre-bankruptcy structure and entities are still allowed to emerge as separate.[68] This will enhance competition and attract more resolution plans.

(b) Issues relating to timelines

While substantive consolidation is a powerful tool which can be employed to achieve what the insolvency law would otherwise deny, its adoption, especially under the IBC, must be considered with caution. Since the scheme of the IBC is to resolve the financial stress of the CD in a time-bound manner, it prescribes strict timelines for each stage of the insolvency resolution process with the insolvency commencement date as the benchmark for such timelines.

In case of substantive consolidation of group companies under the IBC, key challenges are faced as the insolvency commencement date for each of the group companies is different and consequently, collation of creditors' claims, preparation of valuation reports, and ascertainment of CIRP costs correspond to different dates. This makes it difficult to find common value, consolidate claims and allocate costs in the CIRP of a CD. Further, absence of a common insolvency commencement date would also be problematic for initiating of avoidance proceedings as the look-back periods for preference, undervalued and extortionate transactions are also measured from this date.[69]

(c) Difficulties in application of substantive consolidation and resolving issues in the current framework for single entities

Lenders usually have different loan profiles and varying priority and value of security interests against the loans extended to a company. Even where the court requires substantive consolidation, in practice managing the expectations of heterogeneous creditors proves difficult and creates conflicts in the resolution and distribution mechanism.[70] Further, prior to introducing a formal framework for group companies, the IBC requires amendments to clarify certain fundamental concepts such as recognition of value and priority of security interest held by creditors. Jurisprudence developed under the IBC has consistently disregarded the value and priority of security held by creditors as mandatory factors whilst determining pay-outs to both assenting and dissenting FCs under a resolution plan approved for the CD.[71]

Even during liquidation process, inter-se priorities amongst secured creditors under section 53 of the IBC have not been recognised once the secured creditor has elected to forego their right to enforce the security interest.[72] Unless these fundamental issues are urgently addressed through course-correction, concerns involving heterogenous creditors will be further intensified in a group insolvency situation. There are also difficulties in applying substantive consolidation to those creditors that have not dealt with the group as a whole, and whose claims ought to be treated only vis-à-vis specific entities and not the whole group.

(d) Ad hocism

The absence of clear rules and legal guidance for group insolvency leads to *ad hoc* gap filling by the NCLTs often requiring them to determine executive and legislative policy. For instance, in the *Videocon Case*, the NCLT Mumbai ordered substantive consolidation despite no clear indication to this effect by the Parliament. This explicitly transgressed the roles and powers envisaged for the NCLT, which being a creature of statute ought to operate within the parameters of the IBC. A clear and comprehensive framework for group insolvency for corporate groups would overcome the need to rely on judicial discretion and synthetic restructuring as was seen in the *Videocon Case* and a plethora of cases thereafter. Such *ad hocism* makes the insolvency law uncertain and unpredictable, which can potentially be construed as a significant shortcoming on a global level and can discourage foreign investment in India.

POLICY RECOMMENDATIONS FOR A PROPOSED GROUP INSOLVENCY FRAMEWORK

Although the benefits of recognising the interlinkages between corporate groups were not considered while contemplating the design of the IBC, policymakers have acknowledged the need for a group insolvency framework under the IBC since its enactment. In January, 2019, the Insolvency and Bankruptcy Board of India (IBBI) set up a Working Group on Group Insolvency under the chairmanship of Mr. U.K. Sinha.[73] The Working Group submitted its Report in September, 2019 (Working Group Report) containing recommendations for the design of a comprehensive group insolvency framework and proposed amendments to the IBC.[74] Thereafter, in February, 2020, the Ministry of Corporate Affairs tasked the Cross Border Insolvency Rules/Regulations Committee to propose a framework for group insolvency under the IBC in light of the recent adoption of the MLEGI by UNCITRAL[75]. The Committee submitted its Report in December, 2021 (CBIRC Report).[76]

Despite the above, provisions to deal with the insolvency of corporate groups have not been introduced in the IBC. The policy deliberations contained in the above-mentioned reports (Proposed Framework), however, are the foundational step towards developing an effective mechanism to maximise value of corporate groups in insolvency proceedings. Therefore, the key recommendations contained in these reports are provided below.

Key Recommendations - Working Group Report

The Working Group Report recommends principles for designing a comprehensive and effective framework for group insolvency in India. This framework is designed to be voluntary, enabling and flexible in nature and contains several mechanisms to coordinate the insolvency proceedings of group companies. Some or all such mechanisms may be employed in a case depending on its facts and circumstances. An overview of the group insolvency framework recommended by the Working Group Report is as follows:

a) **Scope and applicability*:*** The Working Group considered three types of remedies for resolving or liquidating group companies - procedural coordination, substantive consolidation, and rules to deal with perverse behaviour. To ensure ease of implementation, the Working Group recommends that the law may provide for a phased implementation of the Proposed Framework. In the first phase, the law may only provide for procedural coordination of domestic companies in groups and rules against perverse behaviour. The first phase would not deal with cross-border group insolvency and substantive consolidation, which may be considered at a later stage based on experience in implementing the first phase.

b) **Meaning of 'Group'*:*** The Proposed Framework is envisaged to apply to 'corporate groups' which is defined to mean holding, subsidiary, and associate companies, as defined under the Companies Act, 2013. To ensure that this definition is sufficiently wide, the Working Group suggests that an application may be made to the Adjudicating Authority (AA) to include companies that '*are so intrinsically linked as to form part of a 'group' in commercial understanding, but are not covered by the definition of corporate group above*'.[77] Additionally, the mechanisms for procedural coordination would only be applicable to those companies belonging to a group against whom insolvency or liquidation proceedings have been initiated under the IBC and would not apply to solvent group companies.

c) **Mechanisms for procedural coordination***:* The Proposed Framework provides for several procedural coordination mechanisms that are targeted at coordinating the 'procedures' of insolvency proceedings of different group companies while keeping their assets separate. Procedural coordination may take different forms in different cases, depending on what the stakeholders consider would lead to the most value maximising solution based on the relevant facts and circumstances. First, a joint application may be made against all CDs who have committed a default and who form part of a group. Such application may be made before any AA that has jurisdiction over any one of the companies. Second, the law may enable appointment of a single Insolvency Professional (IP) and designation of a single AA for resolving the CIRP or liquidation proceedings of multiple group companies. Third, the CoC of the group companies may be enabled to choose to form a group CoC that supports the individual CoCs. Fourth, the CoCs of the group companies may choose to initiate group coordination proceedings to arrive at a strategy for the synchronised resolution of insolvency or liquidation of the group companies. Fifth, it would be mandatory for the IPs, CoCs and AAs of the group companies to cooperate, communicate and share information with each other.

d) **Rules against perverse behaviour*:*** In addition to the current provisions of the IBC regarding avoidance of certain transactions and imposition of liability for fraudulent and wrongful trading, the Proposed Framework may also permit the AA to subordinate the claims of other group companies in exceptional circumstances of fraud, etc. to effectively address any perverse behaviour of group companies.

Key Recommendations – CBIRC Report

To arrive at its recommendations, the Working Group Report considered the law and jurisprudence on group insolvency in several jurisdictions and international instruments like the EU Regulations and the UNCITRAL Guide. However, since the MLEGI was released shortly before the release of the report of the Working Group, the framework suggested in its Report does not consider the recommendations of the MLEGI on group insolvency. Thus, the CBIRC Report considers the Working Group Report in comparison with the MLEGI and an overview of the CBIRC's recommendations is as follows:

a) **Scope and nature:** The CBIRC agreed with the Working Group's recommendation that the Proposed Framework should be voluntary, enabling and flexible in nature, and should be implemented in phases. It also agreed that in the first phase of implementation, the law should be limited to domestic group companies and should only provide for procedural coordination mechanisms.

b) **Adoption of the MLEGI and cross-border group insolvency:** The CBIRC suggests that the MLEGI may not be adopted in India in the first phase of implementing the Proposed Framework. The provisions of the MLEGI chiefly deal with cross-border issues that may arise in the insolvency of multinational enterprise groups. Noting that India currently lacks experience in dealing with cross-border insolvency cases even on a single entity basis, the CBIRC recommends that adoption of the MLEGI may be considered after enactment of single entity cross border insolvency laws and based on learnings from its implementation.

c) **Definition of 'group':** The CBIRC Report deviates from the recommendation of the Working Group and suggests that a broad and inclusive definition of 'group' should be provided to ensure inclusion of a large number of CDs within the ambit of the Proposed Framework. This definition should be based on the criteria of control and significant ownership, and it may be clarified that this includes holding, subsidiary and associate companies as defined under the Companies Act, 2013. Further, the Working Group Report only dealt with companies. The CBIRC notes that 'CDs' under the IBC includes both companies and limited liability partnerships (LLPs), and thus suggests that the definition of 'group' should also account for LLPs.

d) **Procedural coordination:** The CBIRC agrees with most of the recommendations of the Working Group regarding procedural coordination mechanisms. In relation to having a single AA, however, it deviates from the Working Group by recommending that transfer of all insolvency proceedings to the same NCLT should be mandatory. The CBIRC Report also provides a detailed framework for the conduct of the group coordination proceedings and manner of arriving at a group strategy for resolution or liquidation.

e) **Rules to deal with perverse behavior:** The CBIRC notes that provisions dealing with avoidance actions and fraudulent or wrongful trading under the IBC may be sufficient to address any perverse behaviour by group companies. It, therefore, recommends that specific provisions to deal with perverse behaviour may not be required, and such provisions should be legislated based on practice developed on group insolvency under the IBC in due course.

ISSUES WITH THE PROPOSED FRAMEWORK

Definition of 'corporate group'

The manner of defining the term 'group' or 'corporate group' to whom the Proposed Framework applies forms the bedrock of the law on group insolvency. Various Indian statutes and legislative instruments provide distinct definitions of the term 'group', depending on the context of the relevant statute or instrument. Although the Companies Act, 2013 does not define the term 'group', it provides ingredients of a group by defining terms like 'holding company', 'subsidiary company' and 'associate company'.[78] Despite the distinctions, all these definitions are made in reference to some degree of control and ownership.[79]

As discussed above, the Working Group Report recommends that a corporate group may be defined to mean holding, subsidiary, and associate companies, as defined under the Companies Act, 2013, while also allowing the AA discretion to include other companies that are so intrinsically linked as to form part of a group in commercial understanding. This is a formal approach to defining a 'group' as it is based on definitive parent, subsidiary or associate relationships that are based on specified thresholds of control and ownership.[80] This approach has the benefit of providing stakeholders with ex-ante certainty and will allow creditors to have prior knowledge, at the time of granting credit, regarding whether they are interacting with a member of a group for the purposes of the IBC.

Nevertheless, the formal approach suggested by the Working Group also has some significant disadvantages. First, the concepts of holding, subsidiary, and associate companies under the Companies Act, 2013 may be difficult to translate in cross-border scenarios as these definitions apply only to companies and bodies corporate incorporated or registered in India.[81] Thereby, the definition of 'group' would have to be altered if cross-border group insolvency is introduced in the law or a separate definition of 'group' may be required to be provided to account for foreign companies. Either of these scenarios may not be ideal.

Second, solely relying on these definitions under the Companies Act, 2013 may not sufficiently include all cases where recourse to a group insolvency framework may be beneficial. For example, where, instead of equity, control in a company is exercised by another company through strategic alliances and contractual arrangements like franchisees, distributors, licensees, and other independent contractors.[82] Given this, the Working Group suggests that the AA should have discretion to include other companies.[83] However, the meaning of the term 'commercial understanding' is not defined and may be considered vague and unenforceable. The ambiguity of the term may result in frivolous litigation, thus hindering the insolvency process.[84] Further, a wide interpretation of this term may also lead to uncertainty amongst stakeholders, undermining the purported advantage of *ex-ante* clarity for stakeholders.

Thus, a functional approach to defining 'group' may be better suited as it would allow a broad and inclusive mechanism for determination of group companies that is principle driven. A similar approach is also recommended in the UNCITRAL Guide, the MLEGI, and the CBIRC Report, all of which suggest that the term 'group' should be defined to mean two or more companies interconnected by control or significant ownership which would apply to both domestic and cross-border groups. Such a definition would allow the AA to determine companies that should be treated as a group in line with the economic realities based on which the relevant companies operate. Additionally, to ensure clarity and consistency in interpretation, the terms 'control' and 'significant ownership' must also be defined, and it may be clarified that the definition of group includes holding, subsidiary, and associate companies under the Companies Act, 2013. A similar recommendation has also been made in the CBIRC Report. Notably, this approach should also be extended to LLPs so as to apply to all relevant forms in which a CD may be established.

Need for guidance on substantive consolidation

Substantive consolidation is a mechanism whereby the assets and liabilities of different group companies are consolidated and treated as part of a single insolvency estate for the purpose of reorganization or distribution in liquidation. It is arguably one of the most controversial remedies for dealing with group insolvency as it disregards certain foundational principles of corporate law, such as the concept of limited liability of corporations and entity separateness. Although piercing the corporate veil and substantive consolidation are related doctrines since they both propose to mitigate the fraudulent use of the corporate form, substantive consolidation goes beyond mere piercing as it pools assets horizontally as well as vertically.[85] Therefore, global jurisprudence establishes substantive consolidation as a rare remedy reserved for special circumstances where benefits of consolidation outweigh its costs.

When applied in fit cases, however, substantive consolidation has several benefits. First, where assets of group companies are so intermingled that they cannot be separated without disproportionate costs or time, consolidation may be beneficial in making the process cheaper and quicker. It also helps save time and effort that would have otherwise been spent in identifying the dynamics of the related party transactions and, thereafter, in pursuing the inter-company or intra-group claim. Second, it may fulfill expectations of creditors and other stakeholders who would have dealt with the companies as a single economic entity and expect a consolidation to maximize the value of the estates collectively. Finally, substantive consolidation may help avoid the abuse of the corporate form where the consolidation can rectify fraudulent activities.

It is not surprising therefore, that AAs have passed substantive consolidation orders in the several cases (see discussion on *Videocon case* and subsequent judgments discussed under the heading 'Group Insolvency under the IBC' above). Despite this, both the Working Group and the CBIRC Reports have recommended that provisions on substantive consolidation should not be introduced in the first phase of the implementation of the Proposed Framework. This recommendation would leave a crucial lacuna in the law and may require reconsideration.

Firstly, substantive consolidation has been ordered in several cases by the AA based on principles laid down in the *Videocon case*. This has led to variance between the provisions of the statute and practice under the IBC. Secondly, ordering consolidation of assets and liabilities of a group of companies is a wide power and the provisions of the IBC, and subordinate legislation framed thereunder, arguably do not grant sufficient powers to the NCLT to pass such orders. Currently, the NCLT issues such orders by exercising its inherent powers as contained in Rule 11 of the National Company Law Tribunal Rules, 2016 (NCLT Rules). While the rules framed under the IBC do not extend the applicability of Rule 11 of the NCLT Rules to proceedings under the IBC,[86] in practice, Rule 11 has still been applied.[87]

The NCLT, while acting as the AA under the IBC, is a creature of a statute and cannot be construed to have powers that have not been envisaged in law. Moreover, the intent of the Bankruptcy Law Reforms Committee was to limit powers of the NCLT to ensure statutory compliance and granting wide inherent powers to the AA under the IBC may deviate from this intent.[88] Thus, provisions enabling the AA to order substantive consolidation are currently lacking.

Thirdly, substantive consolidation mechanisms may result in different forms of consolidation of assets and liabilities. In some cases, all the assets and liabilities may be consolidated. On the other hand, in instances where consolidation prejudices the interests of certain creditors, such creditors may be excluded from the scope of consolidation, which is known as partial consolidation. Further, in some other cases, claims may be consolidated for the purposes of voting, distribution, etc., but the final entities emerging post the resolution are still organized as different entities. This is known as deemed consolidation and is typically utilised in cases where entity separation has value.[89] Such nuances of these distinct forms of substantive consolidation are diluted due to the lack of a legislative framework for the same.

Cross-border issues in group insolvency

The issue of insolvency of corporate groups is most relevant for larger corporates, many of whom have a global presence. Hence, cross-border issues routinely arise when Indian companies incorporate foreign enterprises for carrying out global business or domestic enterprises for carrying out diverse businesses and these give rise to group insolvency matters whenever there is a default affecting multiple entities. Increasing globalisation of economic activity has led to significant growth in the number of enterprise groups in international trade and commerce, both domestically and internationally. It is therefore vital that a transparent and predictable regime exists to ensure adequate and coordinated approaches to the insolvency of group members and treatment of the group as a whole, and that it facilitates, rather than hinders, the fast and efficient conduct of insolvency proceedings.

As noted above, the Working Group and CBIRC Reports recommend that provisions dealing with cross-border issues involved in the insolvency proceedings of groups may not be introduced in the IBC at present. They also recommend that such provisions may be enacted after experience in implementing a single-entity cross-border insolvency is gained in India. India has proposed adoption of the cross-border insolvency provisions *pari materia* with the UNCITRAL Model Law on Cross-Border Insolvency, 1997 (Model Law). The Model Law was enacted 25 years ago in 1997, is limited to only single entities, and stops short of dealing with the insolvency of corporate groups satisfactorily.

Limiting the cross-border insolvency law in India to single-entity issues only will leave a significant lacuna in the law. Due to taxation benefits, formation of group structures to operate across national borders is far more common than establishing branches of a single entity. Indian companies setting up a branch abroad or a foreign company setting up an Indian branch is becoming rare. In a single entity concept where a branch is employed for cross-border trade, there is only one legal entity and one corporate personality to be dealt with, which therefore leaves out the more popular and predominant forms of subsidiaries, holding companies, joint ventures or associate companies from the cross-border insolvency law. Nations are competing to be recognised as the hub of international restructuring which rehabilitates global operations and companies. India must seriously examine whether it should incorporate a law which is outdated and suffers a huge disadvantage when contrasted with a wider law that resolves enterprise insolvency where several companies operate as a cohesive group. Notably, the United Kingdom is one of the first countries that has expressed its intention to adopt the MLEGI 'at the earliest opportunity' thereby signalling its ongoing commitment to mutual cooperation and international best practices.[90]

Furthermore, the complexity of the issues involved in the insolvency of group companies is exacerbated when the companies belonging to the group are situated in different countries. For instance, it requires determining the country with jurisdiction over the insolvency proceedings of the group companies and the country whose insolvency law should be applicable to such proceedings. In the absence of any legal guidance on determination of such issues, this would be left to the AA to decide. This is not only burdensome and time-consuming but also requires the tribunal to decide matters of policy, such as choosing between the approaches of territorialism, universalism, and its hybrids forms.[91] Additionally, in the absence of a cross-border framework for groups, there may be difficulties in coordination with foreign representatives and taking control of foreign assets. This may leave the debtor with foreign liabilities but without foreign assets. For example, attempts at including assets of the Videocon group companies, held in foreign countries through subsidiaries, within the Indian insolvency proceedings have not materialised.

Moreover, enforcing Indian orders against foreign companies will remain a challenge in the absence of a holistic cross-border insolvency framework that is supplemented by agreements with foreign countries. Several remedies ordered by the AA to efficiently resolve a group may inevitably involve foreign companies. For instance, beneficiaries in avoidance transactions, wrongdoers in fraudulent or wrongful trading, etc. may be foreign companies who may evade any repercussions by refusing to submit to the jurisdiction of the NCLT thereby rendering any orders against them practically unenforceable.

Finally, the global economy is being shaped by digital transformation and the proliferation of complex corporate structures permeating multiple jurisdictions and facilitating the conduct of business across borders. In adopting the Model Law for only single entities, India is not keeping pace with the rapidly changing economic and financial circumstances thereby seriously disadvantaging itself when competing with other nations in the sphere of cross-border restructuring and insolvency resolution. E.g. Singapore has taken active steps to become an international hub for debt restructuring based on three primary strategies: (a) development of business and institutional environment (b) modernisation of its insolvency laws and (c) enhancing its leadership in the international insolvency debate.[92]

Rules to deal with perverse behaviour

The concept of limited liability and separate legal personality of companies as laid down in *Salomon v. Salomon*[93] forms the bedrock of modern corporate law. Although *Salomon* predated corporate groups, these concepts are key to the popularity of group structures in the current corporate reality.[94] While preserving the separate legal personality of a company is significant, it is not absolute. Common-law jurisprudence has established certain grounds on which courts may ignore such separate legal personality, e.g., courts may pierce the corporate veil on grounds such as fraud, impropriety, subsidiary acting as an agent of the parent company, etc.[95]

Similarly, in scenarios where a group company is undergoing insolvency proceedings, rules permitting courts to ignore the separate legal personality of such company and hold its group member(s) accountable for the perverse behaviour of group companies are required. Such rules aim to address the exploitation of the group structure to conduct transactions that impose an undue burden on creditors while unfairly benefitting shareholders.[96] An apparent benefit of such rules dealing with perverse behaviour of corporate groups is that they address wrongdoing by such groups in a manner that increases recovery for external creditors. Further, such rules also ensure that the group affords the costs of monitoring activities of group companies and takes early action in case of financial distress, instead of imposing such costs on creditors.

Both the Working Group and the CBIRC Reports note the importance of such rules in the insolvency of group companies, however, their recommendations fall short in providing a comprehensive framework for the same. While there are limited remedies under the IBC that may be helpful in addressing certain wrongful or undesirable actions of the CD,[97] these do not sufficiently equip the AA to detangle the complex web of financial transactions of groups for the benefit of creditors as a whole. For instance, the insolvency laws of several foreign jurisdictions provide additional remedies to deal with group insolvency cases like subordination of intra-group claims, extension of liability, and contribution orders:

- The power of subordination allows courts to, in certain circumstances, require the claims of other group entities to be treated subordinate to the claims of unrelated creditors in the insolvency resolution of any one group company. For instance, a parent company's claims in the insolvency proceeding of its subsidiary may be subordinated if the parent company has attempted to manipulate intra-group transactions to its own advantage at the cost of external creditors or has behaved unfairly through '*imposition* *of excessive management or consulting fees or dividend policies designed to strip the controlled group member of its funds*',[98] etc. The US Bankruptcy Code equips the court with a general power to subordinate any claim on equitable grounds, that has also been utilised to subordinate intra-group claims.[99] The US Supreme Court in *Taylor v. Standard Gas & Elec. Co.*[100] subordinated the claims of the parent company of the debtor noting that the parent company was guilty of mismanagement and under-capitalisation the debtor company.

- Extension of liability orders are provided for in some jurisdictions whereby certain liabilities of the insolvent company are extended to other group members by the court. Such orders are given based on the degree of control or ownership exercised in the insolvent company and its unfair use by other group companies. For instance, the Australian insolvency law permits holding the parent company liable for the debts incurred by its subsidiary if such subsidiary was insolvent at the time of taking such debts or became insolvent as a result of such debts, and the parent company failed to mitigate the same.[101] The UNCITRAL Guide also provides a list of circumstances warranting extension of liability; including fraudulently siphoning off a group member's assets or increasing its liabilities, conducting the affairs of the group member with an intent to defraud creditors, operation of a group member as the parent's agent, trustee or partner, etc.[102]
- Few jurisdictions also permit courts to pass contribution orders that require a solvent group member to contribute specific funds to cover all or some of the debts of other group members subject to insolvency proceedings.[103] Such orders are rare and may be passed in limited circumstances where the solvent group member has acted wrongfully but are not passed at the cost of solvency of such group member.[104]

A framework for group insolvency under the IBC would be incomplete if the AA is not bestowed with the power to exercise one or all the above remedies to address fraud and mismanagement within groups. Even in the absence of a group insolvency framework under the IBC presently, there are cases where subordination orders have been made[105] and separate legal personality has been disregarded in order to hold parent entities liable for debts of their insolvent subsidiaries.[106] The lack of a legislative framework basis which such orders are passed leads to uncertainty and unpredictability.

Managing timelines

One of the key issues in dealing with substantive consolidation under the IBC is managing competing timelines of different group companies.

Since the insolvency commencement date for each of the group companies is different, the timeline for various steps in the insolvency process is distinct which makes coordination of proceedings difficult. Similar issues with coordination of proceedings may also arise in instances of procedural coordination. Further, as noted above, absence of a common insolvency commencement date would also be problematic for initiating of avoidance proceedings in respect of substantively consolidated companies as the look-back periods for preference, undervalued and extortionate transactions are also measured from this date.[107]

Despite the above, the Working Group and CBIRC Reports do not provide any specific recommendations regarding determination of a common insolvency commencement date for consolidated companies. This would lead to a lacuna in the law and suitable enabling provisions for the same may be included in the IBC. Further, the AA may be permitted to alter timelines for group companies that are subject to procedural coordination, on the request of the CoCs of the group companies, the IP or the group coordinator (if any).

Making NCLTs and IPs ready

The adjudication of group insolvency involving complex structures and international presence requires awareness and familiarity with different legal systems across the globe. India must ensure that NCLTs and IPs are well equipped to undertake complex restructurings and in cases of cross-border insolvency of group companies, to engage in international dialogue and develop efficient protocols for cross-border cooperation. In relation to cross-border insolvency and the concerned courts/ tribunals dealing with such matters, protocols and standard procedures applicable across multiple territories require to be established. It would be disorderly if every bench of the NCLT had the power or authority to make its own protocols on a case-by-case basis. Thus, there is an imperative need to have mutually acceptable protocols between countries engaged in cross-border insolvency resolution, in a standard form free from arbitrariness. Further, efforts must be made towards capacity building initiatives as well as knowledge sharing and training initiatives to hone the competence and expertise of the NCLT members as well as the IPs.

Lack of proper infrastructure, capacity considerations and pending litigations at the NCLTs leads to inordinate delays which may assume even greater significance in group insolvency cases given the substantially larger quantum of debt exposure and value involved as opposed to the insolvency of single entities. Further, in cases of cross-border group insolvency, issues relating to delays and breach of timelines are likely to reflect the competence and reputation of the Indian judiciary to adjudicate such matters on a global level. Therefore, it is crucial to ensure India has the requisite human resources and infrastructure to adjudicate such matters prior to introducing a formal framework.

CONCLUSION

While the enactment of a modern legislation such as the IBC has played a crucial in aligning India's insolvency law with the global best practices, however, it is far from being considered complete and comprehensive in all aspects. While a law cannot possibly legislate for all ground economic realities, providing a predictable insolvency regime for the insolvency of group companies is the need of the hour. More so, as group structures have become increasingly popular among Indian companies which have set up branches, subsidiaries, and associate companies in foreign jurisdictions. Indian companies also list securities on international stock exchanges, as dual listing is permissible, with deployment of such capital often taking place through the institution of subsidiaries or joint ventures globally. In these circumstances, relying solely on judicial innovation leads to uncertainty and inconsistent outcomes which ultimately have a significant degrading effect on the economy.

[1] OECD (2022), Company Groups in India.
[2] *Ibid.*
[3] Kokorin I. (2021), "The Rise of 'Group Solution' in Insolvency Law and Bank Resolution".
[4] Krishan S. and Khara R. (2021), "All for one, one for all: Decoding Group Insolvencies in India", IBBI Quinquennial of Insolvency and Bankruptcy Code, 2016, p. 469.
[5] Regulation (EU) 2015/848 of the European Parliament and of the Council on insolvency proceedings, May 20, 2015.
[6] Report of the European Parliament's Committee on Legal Affairs on Insolvency proceedings in case of groups of companies, March 2011.
[7] *Ibid.*
[8] UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment, 2019.
[9] Ch. 3, Para 22, UNCITRAL Guide.
[10] Recommendation 220, UNCITRAL Guide.
[11] Supra Note 5.
[12] Bruder F. (2017), "Germany introduces legislation to facilitate corporate group insolvencies (Konzerninsolvenzrecht)", DLA Piper.
[13] Brasher A. (2006), "Substantive Consolidation: A Critical Examination", p. 4.
[14] Section 271(1)(b), Companies Act, 1992 (New Zealand).
[15] Sections 571 to 579L of the Corporations Act, 2001 (Australia).
[16] American Bankruptcy Institute, Practical Business Guidelines for Dealing with Substantive Consolidation.
[17] In re Genesis Health Ventures, Inc., 402 F.3d 416 (3d Cir. 2005) (United States).
[18] Section 510(c), 11 U.S. Code.
[19] Section 272, Companies Act, 1993 (New Zealand); Section 140, Companies Act, 1990 (Ireland).
[20] Sections 588V, 588W, Corporations Act, 2001 (Australia); Section 251, Insolvency Act, 1986 (United Kingdom).
[21] Recommendation 199-201, UNCITRAL Guide.
[22] Recommendation 204, UNCITRAL Guide.
[23] Recommendation 220, UNCITRAL Guide.
[24] Recommendation 239, UNCITRAL Guide.
[25] Recommendations 24-245, UNCITRAL Guide.

[26] Recommendation 253-254, UNCITRAL Guide.

[27] Article 2(b), MLEGI.

[28]Article 2(c) of the MLEGI defines 'control' as the capacity to determine, directly or indirectly, the operating and financial policies of an enterprise.

[29] Para 39, Guide to Enactment, MLEGI.

[30] Para 35, Guide to Enactment, MLEGI.

[31] A group insolvency solution involves the development of proposals for the resolution or liquidation of enterprise group members, with a view to preserve/ enhance their value as a whole. (Article 2(f), MLEGI).

[32] Article 2(g), MLEGI.

[33] Article 2(e), MLEGI; Article 2(g)(iii), MLEGI.

[34] Article 19, MLEGI.

[35] Para 45, Guide to Enactment, MLEGI.

[36] Article 23, MLEGI.

[37] Articles 21, 26, MLEGI.

[38] Articles 18, 25, MLEGI.

[39] Article 24(3), MLEGI.

[40] "Insolvency representative" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the enterprise group member debtor's assets or affairs or to act as a representative of the insolvency proceeding (Article 2(i), MLEGI).

[41] Article 28, MLEGI.

[42] Article 30, MLEGI; Para 212 Guide to Enactment of the MLEGI.

[43] Article 12, MEGI.

[44] Article 15(a), MLEGI.

[45] Article 10(c), MLEGI.

[46] Article 17, MLEGI.

[47] Article 10(f), MLEGI.

[48] Para 105, Guide to Enactment; Article 18(4), MLEGI.

[49] IBBI (2019), "Report of the Working Group on Group Insolvency", p. 20.

[50] (2019) SCC OnLine NCLT 745.

[51] *Axis Bank Ltd. v. Lavasa Corporation Ltd.*, (2020 SCC OnLine NCLT 3484)*; Shailesh Verma v. Dasve Retail Limited* (IA 2239/MB/C-II/2020 In CP (IB) 937/MB/C-II/2020*)*, Order dated 13th March 2021; *TJSB Sahakari Bank Ltd. v. Mr. Kshitiz Gupta & Ors* (I.A. 1068/2020 in C.P. 547/I&B/MB/2020), Order dated 16th April 2020; *Sanghvi Movers v. M/S Albanna Engineering (India) Pvt. Ltd. (MA/25/KOB/2020 in IBA/38/KOB/2019),* Order dated 20th April 2020.

[52] *Radico Khaitan Ltd v. BT & FC Pvt Ltd.* (Company Appeal (AT)(Insolvency)No.919/ 2020), Order dated 26th March 2021; *Jitendra Arora, RP of M/S Premia Projects Ltd. v. Tek Chand & Anr.*, Company Appeal (AT) (Ins) No. 1069 of 2020 (NCLAT, New Delhi), Order dated 18th November 2021.

[53] *Jitendra Arora, RP of M/S Premia Projects Ltd. v. Tek Chand & Anr.*, Company Appeal (AT) (Ins) No. 1069 of 2020 (NCLAT, New Delhi), Order dated 18th November 2021; *Axis Bank Ltd. v. Lavasa Corporation Ltd.* 2020 SCC OnLine NCLT 3484.

[54] *(IA No. 32/2020 in CP(IB) No.492/07/HDB/2019)* NCLT, Hyderabad, order dated 12th February 2021.

[55] *Punjab National bank v. KSK Mahanadi Power Company Limited & Ors.*, (Company Appeal (AT)(CH)(INS) No.46/2021).

[56] *State Bank of India & Anr. v. Videocon Industries Limited & Ors,* (2019) SCC OnLine NCLT 745.

[57] *Mrs. Mamtha v. AMB Infrabuild Private Limited,* (2018) SCC OnLine NCLAT 785.

[58] *Edelweiss ARC v. Sachet Infrastructure,* (2019) SCC OnLine NCLAT 592; *Venugopal N.*

Dhoot v. State Bank of India & Ors. (2018) SCC OnLine NCLT 29551, Order dated 24th October 2018.

[59] *Edelweiss ARC v. Sachet Infrastructure* (2019) SCC OnLine NCLAT 592; *Radico Khaitan Ltd v. BT & FC Pvt Ltd.* (Company Appeal (AT)(Insolvency)No.919/2020), Order dated 26th March 2021.

[60] *Edelweiss ARC v. Sachet Infrastructure* (2019) SCC OnLine NCLAT 592; *Punjab National Bank v. KSK Mahanadi Power Company Limited & Ors.* (IA No. 32/2020 in CP(IB) No.492/07/HDB/2019), Order dated 12th February 2021.

[61] *Mr. Ajit Kumar, RP of K-Lifestyle & Industries Limited v. Ms. Manasi Wadekar*, Company Appeal (AT) (Ins) No.185 of 2021, Order dated 10th March 2021.

[62] *State Bank of India v. Adhunik Metaliks Ltd.*, C.P. No. (IB) No. 373/KB/2017, order dated 3rd August 2017; *State Bank of India v. Zion Steel Ltd.*, C.P. No. (IB) No. 372/ KB/ 2017.

[63] *J.R. Agro Industries P. Ltd v Swadisht Oils P. Ltd*, Company Application No. 59 of 2018 in Company Petition No. (IB)13/ALD/2017.- decision dated 24.07.2018, Para 100-101.

[64] *Bikram Chatterji v. Union of India* (2018) 17 SCC 707); *Chitra Sharma v. Union of India* (2018) 18 SCC 575).

[65] INSOL World, The Quarterly Journal of INSOL International, 4th Quarter, 2017.

[66] Gilbert J. (1990), "Substantive Consolidation in Bankruptcy: A Primer", 43 Vanderbilt Law Review 207.

[67] *In re Genesis Health Ventures, Inc.,* 402 F.3d 416 (3d Cir. 2005) (United States).

[68] Supra Note 16.

[69] Supra Note 66, p. 233.

[70] Rawat A. & Khan A. (2022), "Issues and challenges of group insolvency in India", Asia Business Law Journal.

[71] *India Resurgence ARC Private Limited v. M/S Amit Metaliks Limited*, 2021 SCC online SC 409.

[72] *Technology Development Board v. Mr. Anil Goel & Ors.*, [2021] NCLAT, Company Appeal (AT) Insolvency No. 731 of 2020.

[73] The members of the Working Group are Mr. UK Sinha (Chairperson), Ms. Anshula Kant, Mr. Shardul Shroff, Dr. Shubhashis Gangopadhyay, Mr. Siby Antony, Mr. Koushik Chatterjee and Mr. Sumit Binani. The invitees to the WG are Mr. Sumant Batra, Dr. S. K. Gupta, Ms. Alka Kapoor and Mr. Sunil Pant.

[74] Report of the Working Group on Group Insolvency, 23rd September 2019.

[75] The members of the CBIRC are Dr. K.P. Krishnan (Chairperson), Mr. A.M. Baja, Mr. Challa Sreenivasulu Setty, Mr. Harshvardhan Ragunath, Mr. Somasekhar Sundaresan, Ms. Aparna Ravi, Mr. Abizer Diwanji, and Mr. Methil Unnikrishnan.

[76] Report of the CBIRC-II on Group Insolvency, December, 2021.

[77] Part III, Para 3.3, Working Group Report.

[78] Sections 2(6), 2(46), 2(87), Companies Act, 2013. Further, Section 370 of the Companies Act, 1956 provides for 'Loans etc. to companies under the same management' and Section 370(1B) provides for the instances where two body corporates would be deemed be under the same management. The instances include commonality in the management, directors, exercise of voting power or control by the same individual or body corporate and ownership.

[79] Working Group Report, p 27.

[80] UNCITRAL Guide, Chapter 1, para 28.

[81] Section 1 of the Companies Act, 2013 lays down the list of entities to which the provisions of the Companies Act, 2013 apply, which includes companies incorporated under that Act or previous company law, companies governed by special laws, incorporated under any law in force in India, as notified by the Central Government etc. While Chapter XXII of this Act governs foreign companies, this only includes those foreign companies requiring registration in India by virtue of their business presence in India. *See* definition of 'foreign company' in Section 2(47) of the Companies

Act, 2013. Thus, body corporates incorporated outside India not requiring registration in India would not be referred to as a 'foreign company' under the Companies Act, 2013 (except Section 234(2)).

[82] Virginia Harper Ho, Theories of Corporate Groups: Corporate Identity Reconceived, (2012) 42 Seton Hall L Rev 879, See also Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. & Ors., Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.

[83] Authors' Note: This should only be permitted under strict conditions and qualifications.

[84] Poorna Poovamma K. M & Wadhawan A. (2021), "Introduction of Group Insolvency Regime in India: Identifying the Challenges and Proposing the Solutions", NLIU Law Review, vol X issue 1.

[85] Supra Note 16, p. 7.

[86] Rule 10(1), Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

[87] This gap in the law requires the MCA to come out with NCLT rules specifically conferring upon NCLT inherent powers in IBC proceedings, akin to Rule 11 of the NCLT Rules, 2016.

[88] Ministry of Finance, Report of the Bankruptcy Law Reforms Committee, Volume 1 (November 2015) Para 5

[89] Part IV, Para 3.2, Working Group Report.

[90] The Insolvency Service, Consultation outcome- Implementation of two UNCITRAL Model Laws on Insolvency Consultation.

[91] Mason R. (2008), "Cross Border Insolvency: Where Private International Law and Insolvency Law Meet" in Paul Omar, "International Insolvency Law, Themes and Perspectives", Ashgate Publishing Company, pp. 40-41.

[92] Aurelio Gurrea Martínez, Building a Restructuring Hub: Lessons from Singapore.

[93] [1897] A.C. 22.

[94] Farrar J. (2013), "Piercing the corporate veil in favour of creditors and pooling of groups - a comparative study", Bond Law Review: Vol. 25: Iss. 2, Article 6.

[95] Davies P. and Worthington S., "Gower Principles of Modern Company Law", Sweet & Maxwell, 10th ed., Chapter 8.

[96] Finch V. (2009), "Corporate Insolvency Law Perspectives and Principles", p. 584-6, 2nd Edition.

[97] E.g., avoidance transactions provided in Sections 43-51, fraudulent or wrongful trading in Sections 66-67.

[98] Ch. II, Para 89, UNCITRAL Guide.

[99] Section 510(c), 11 U.S. Code.

[100] 306 U.S. 307, 323 (1939).

[101] Sections 588V, 588W, Corporations Act, 2001 (Australia). *See* also Section 251, Insolvency Act, 1986 (United Kingdom).

[102] Ch. II, Para 97, UNCITRAL Guide.

[103] Section 272, Companies Act, 1993 (New Zealand); Section 140, Companies Act, 1990 (Ireland).

[104] *Lewis v. Poultry Processors* (1988) 4 NZCLC 64. In a scenario where a contribution order leads to insolvency of the previously solvent group company, legitimate claims of the creditors of such company would be required to be paid prior to payments in relation to the contribution order.

[105] *J.R. Agro Industries P. Ltd v. Swadisht Oils P. Ltd*, Company Application No. 59 of 2018 in Company Petition No. (IB)13/ALD/2017.- decision dated 24.07.2018, para 100-101.

[106] *Bikram Chatterji v. Union of India* (2018) 17 SCC 707); Chitra Sharma v. Union of India (2018) 18 SCC 575).

[107] Supra Note 69, p. 233.

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Group Insolvency in India-Need for a Framework

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INTRODUCTION

Group insolvency has become an increasingly complex and challenging issue for countries around the world. In India, the issue of group insolvency has been tackled through *ad-hoc* frameworks, including the Insolvency and Bankruptcy Code, 2016 (IBC/Code).[1] However, despite the introduction of the IBC, the issue of group insolvency continues to pose significant challenges for stakeholders, including businesses, creditors, and regulators.

Group insolvency is a problem that arises when multiple companies within a corporate group become insolvent simultaneously or sequentially. It can also occur as a result of a consolidation process, leading to a domino effect of insolvencies. This issue has become increasingly relevant in India due to the growth of corporate groups in recent years. The problem is significant as the insolvency of one company within a group can have a ripple effect on the other companies/entities within the group, leading to a wider impact on the economy. India currently requires a comprehensive framework for dealing with group insolvency cases, which deals with both substantive consolidation and procedural coordination.[2]

This article presents an analysis of group insolvency within the context of India, specifically addressing the obstacles and practical challenges that hinder its successful implementation. It sheds light on the crucial aspects that any group insolvency framework needs to effectively tackle.

PROCEDURAL COORDINATION AND SUBSTANTIVE CONSOLIDATION

Procedural coordination and substantive consolidation are two key concepts in the context of group insolvency. Procedural coordination refers to the process of coordinating and managing insolvency proceedings involving multiple entities within a group. It involves aligning various procedural aspects, such as filing requirements, timelines, communication, and coordination among different insolvency practitioners, courts, creditors, and other stakeholders. The goal of procedural coordination is to ensure efficiency, consistency, and effective collaboration in handling group insolvency cases.

On the other hand, substantive consolidation pertains to the consolidation of assets, liabilities, and operations of multiple entities within a group into a single consolidated entity for the purpose of insolvency proceedings. In substantive consolidation, the separate legal identities of the individual entities may be disregarded, and their assets and liabilities are pooled together. The objective of substantive consolidation is to achieve a more equitable distribution of assets and liabilities among creditors and to facilitate a comprehensive and efficient resolution of the group's insolvency.

The main difference between procedural coordination and substantive consolidation lies in their focus and scope. Procedural coordination primarily deals with the management and coordination of the procedural aspects of group insolvency cases, ensuring effective communication and cooperation among the relevant parties. It is primarily concerned with the efficient administration of the insolvency process.

On the other hand, substantive consolidation is a substantive legal concept that addresses the consolidation of the assets and liabilities of the group entities. It aims to address the interdependencies and complexities arising from the group structure, allowing for a more comprehensive and fair resolution of the group's insolvency. Substantive consolidation has broader implications as it may involve the merging of legal entities and the pooling of their assets and liabilities.

JURISDICTION OF NCLT TO CONSOLIDATE

The lack of clarity in the Code regarding consolidation criteria and the jurisdiction of the National Company Law Tribunal (NCLT) gives rise to disputes and cause additional delays in group insolvency cases. Moreover, the approval process for consolidation from the NCLT can be time-consuming, further impeding the efficient administration of assets and liabilities.

To address these challenges, the Cross Border Insolvency Rules/ Regulations Committee (CBIRC-II) has, vide their report dated, December 10, 2021 put forth recommendations for enhancing the consolidation process. The CBIRC-II has proposed amending the IBC to allow for the consolidation of insolvency proceedings of related entities within a group, subject to approval by the NCLT. These recommendations aim to simplify the consolidation process and mitigate delays in administering assets and liabilities during group insolvency proceedings.

In the *Embassy Property Developments Private Limited v. State of Karnataka*,[3] the Karnataka High Court deliberated on the jurisdiction of the NCLT in consolidating insolvency proceedings involving entities incorporated under different laws. The Court ruled that the NCLT possesses the authority to consolidate insolvency proceedings of entities incorporated under different laws, as long as they are part of the same group. This judicial decision underscores the significance of the NCLT's jurisdiction in procedural consolidation and provides clarity on the scope of consolidation in group insolvency proceedings.

EXAMINING PAST CASES

The Indian insolvency resolution landscape has witnessed a few high-profile cases of group insolvency in recent years, leading to a growing recognition of the need for a consolidated approach and a framework to resolve insolvency in group companies. In this section, the author examined how consolidation of CIRP was adopted in the *Videocon* case and other cases to achieve the ultimate objective of IBC.

Videocon case

Videocon Industries Limited, headquartered at Mumbai and started in 1984, by Late Shri Nandalal Madhavlal Dhoot, focused on the segment of consumer electronics, home appliances, oil and gas, real estate, and retail. The *State Bank of India v. Videocon Industries Ltd.*[4] is a landmark judgment which boosted the jurisprudence for Indian group insolvency. By relying on principles laid down by US and UK courts, the NCLT Mumbai Bench ruled for consolidation of CIRP for 13 out of 15 companies of the group. It is to be noted that there was no substantive procedure for consolidation previously. Therefore, the Tribunal structured a twin test to determine whether there is a necessity for consolidation.

The twin test deciphered the cases of the Videocon Group in two categories and for the purpose of this categorization, the NCLT examined the existence of certain ingredients viz: (1) Common control, (2) Common directors, (3) Common assets, (4) Common liabilities, (5) Inter-dependence, (6) Inter-lacing of finance, (7) Pooling of resources, (8) Co-existence for survival, (9) Intricate link of subsidiaries, (10) Inter-twined of accounts, (11) Inter-looping of debts, (12) Singleness of economics of units, (13) Cross-shareholding, (14) Inter dependence due to intertwined consolidated accounts, (15) Common pooling of resources, etc. The NCLT also noted that this is not an exhaustive list; and that these are the elementary governing factors, prima-facie to activate the process of 'consolidation'.

The first category encompassed companies within the group whose business operations were tightly interconnected with other entities in the same group. This included shared management, utilization of common human resources across different companies, as well as instances where manufacturing was conducted by one company while distribution was handled by another. Consequently, it was anticipated that the approach of consolidation, rather than segregation, would generate greater value.[5]

The second category encompassed companies within the group, where as a consequence of existing debt agreements, the liabilities had become shared, while the assets remained identifiable. Pursuant to the terms of the loan agreements, one company within the group received a loan while other companies within the same group assumed the role of co-obligor, jointly responsible for the repayment of said loans.

After applying the twin test, the NCLT Mumbai determined that 13 out of the 15 companies belonging to the Videocon Group would undergo consolidation for the purpose of corporate insolvency resolution process (CIRP). However, with regard to two specific entities, namely KAIL Ltd. and Trend Electronics Ltd., the NCLT declined their consolidation. In reaching this decision, the NCLT referred to established jurisprudence under the bankruptcy laws of the US. It emphasized that consolidation should only be denied if it is deemed inequitable or if it poses a greater disadvantage to the stakeholders. Furthermore, the burden of proof to demonstrate the lack of equity or disadvantageous effects on the stakeholders lies with the party opposing the consolidation.

Mentioned below are brief reasons for keeping the following companies out of consolidation:

a) **KAIL Ltd.:** The objection to consolidation was raised by the workers of KAIL Ltd., who provided factual evidence demonstrating the company's ability to operate independently. Their monetary interests, as well as those of the employees, were inclined towards maintaining segregation from the group. Moreover, KAIL Ltd.'s products enjoyed significant demand throughout the country, and its business operations were not reliant on other entities within the group. Consequently, the NCLT concluded that keeping KAIL Ltd. separate from consolidation would position the company in a better position to fulfill its financial obligations.

b) **Trend Electronics Ltd.:** With regards to Trend Electronics Limited, the NCLT observed that the company possesses the necessary capabilities to sustain itself as a going concern independently, without reliance on other group entities. Furthermore, it was noted that if Trend Electronics Limited were to be included in a common CIRP alongside other companies, a unified resolution plan would be implemented. However, considering the company's substantial asset value, treating it on par with other entities could potentially be detrimental to its own resolution prospects.

Cases of non-consolidation

There have been several instances where separate insolvency resolution processes were initiated for entities within corporate groups, such as the Amtek Auto Group, the Uttam Group, the Jet Airways Group, and the Essar Steel Group. The resolution process in the above-mentioned cases adopted *sui generis* mechanisms within the existing framework provided by the IBC. However, the absence of a framework for consolidating entities within a group potentially results in a fragmented approach to resolution. Such fragmented approach may not only introduce inefficiencies and delays but may also undermine the value of the assets held by the group companies. By failing to recognize the potential synergies and interdependence among these entities, their overall value and potential for successful resolution may be compromised.

Therefore, it is imperative to establish a formal framework for consolidation to resolve insolvency in group companies, one that duly recognizes the interdependence of the assets, liabilities, and stakeholders across the various entities of the group.

COMPARATIVE ANALYSIS OF CONSOLIDATION APPROACHES IN INTERNATIONAL JURISDICTIONS

Tests for substantive consolidation - US

When exploring practical solutions for consolidation, it is important to consider how other jurisdictions handle this issue. For example, the US lacks an express provision or statutory framework for consolidating group companies under the US Bankruptcy Code. However, their bankruptcy courts have utilized the 'Doctrine of Substantive Consolidation'. In the case of *In re Snider Brother Inc.*,[6] the Massachusetts Bankruptcy Court outlined two key requirements for substantive consolidation. First, the proponent must demonstrate the necessity of consolidation or the need to prevent harm through consolidation. Second, the benefits derived from consolidation must outweigh any resulting harm to objecting creditors.

Another test, introduced in *Union Saving Bank v. Augie/Restivo Banking Co.*,[7] places the burden on the party seeking consolidation to prove that creditors treated the group as a single economic entity or that the economic affairs are so intertwined that independent insolvency proceedings are impractical.

The widely referenced Auto Train Test, originating from *Drabkin v. Midland Ross Corp*[8] in the District of Columbia Circuit, provides a comprehensive framework for substantive consolidation. This test requires a substantial identity between the entities involved and emphasizes the realization of benefits and avoidance of harms through consolidation. In cases where creditors oppose consolidation, it is only ordered when the benefits outweigh the harms.

These tests serve as important precedents for evaluating substantive consolidation requests in bankruptcy cases, providing criteria to assess the suitability and viability of consolidation while considering the interests of all stakeholders involved.

Tests for substantive consolidation - New Zealand

In contrast, countries like Australia and New Zealand have enacted explicit provisions for consolidating insolvency proceedings. In New Zealand, section 272(2) of the Companies Act of 1992 provides the parameters that the court considers when determining the consolidation of entities for group insolvency. These parameters offer guidance on the factors to be considered in such cases.

Firstly, the court examines the extent to which any of the companies involved participated in the management of other companies within the group. This helps in assessing the level of involvement and influence each company had on the operations of the others.

Secondly, the court considers the conduct of the companies towards the creditors of the other companies. This involves evaluating how each company treated and interacted with the creditors of the other entities, which provides insights into their behavior and financial dealings.

The court also considers the extent to which the circumstances that led to the liquidation of any of the companies can be attributed to the actions of other companies within the group. This helps establish the connection between the actions of one company and the financial difficulties faced by others.

Furthermore, the court examines the degree to which the businesses of the companies have been combined. This factor assesses the level of integration and interdependence among the companies, indicating whether they functioned as a unified economic entity or maintained separate operations.

Finally, section 272(2) allows the court to consider any other relevant matters that it deems appropriate. This grants the court flexibility to evaluate additional factors that may be specific to the case at hand but are not explicitly mentioned in the section.

By considering these parameters outlined in section 272(2), the court can make a well-informed decision regarding the consolidation of entities in group insolvency cases, considering the management involvement, creditor conduct, causal factors, business integration, and any other pertinent aspects deemed necessary by the court.

Analysis

While the US relies on judicially developed tests, New Zealand has a statutory framework that offers guidance to the court. Both jurisdictions aim to ensure the fair and effective administration of group insolvency cases. The US tests focus on the necessity, benefits, and treatment of group entities as a single economic entity, while New Zealand's parameters consider management involvement, creditor conduct, causal factors, and business integration.

In terms of approach, the US adopts a flexible approach through the 'Doctrine of Substantive Consolidation', allowing courts to weigh various factors and assess the interests of stakeholders. In contrast, New Zealand provides a more structured approach with clear parameters outlined in the Companies Act.

In conclusion, while the US relies on judicial interpretation and tests to determine substantive consolidation, New Zealand has enacted specific provisions to guide the court's decision-making process. The US approach emphasizes necessity, benefits, and treating group entities as a single economic entity, while New Zealand's approach focuses on management involvement, creditor conduct, causal factors, and business integration. Both jurisdictions strive to address the complexities of group insolvency and protect the interests of all stakeholders involved in the proceedings.

CHALLENGES AND BOTTLENECKS IN THE CONSOLIDATION PROCESS

The implementation of a comprehensive group insolvency framework necessitates a meticulous consideration of various challenges and bottlenecks that may arise. By addressing these concerns with a detail-oriented approach, the framework can effectively handle complex insolvency situations involving groups of companies. The following key challenges and bottlenecks need to be carefully addressed:

Intermingling of assets

The interdependence of assets among entities within a group poses a significant challenge in the resolution of group insolvency cases.[12] This issue is not exclusive to India but is a global concern, making it crucial to establish an effective cross-border insolvency framework.

In notable cases like *Jet Airways*,[9] the intermingling of assets between the company and other entities within the group complicated the determination of individual liabilities, resulting in delays in the resolution process. While specific measures were taken in the *Jet Airways* case to facilitate cooperation between authorities and the Resolution Professional (RP), the problem of asset interdependence persists and is likely to arise in future cases.

To tackle this issue, the Ministry of Corporate Affairs (MCA) has proposed changes in their discussion paper on group insolvency.[10] The suggested approach emphasizes the importance of maintaining separate accounts and records of assets and liabilities for each entity within the group. This would enable a clear demarcation of assets and liabilities, ensuring a more accurate assessment of each entity's resolvability.

Addressing the challenge of asset interdependence in group insolvency requires the adoption of robust measures that promote transparency and accountability. The proposed changes by the MCA aim to provide a framework that facilitates the efficient resolution of group insolvency cases while ensuring the distinctiveness of assets and liabilities within the group.

Working definition for "Group"

The absence of a well-defined and precise working definition creates difficulties in accurately determining the inclusion of entities within a group, consequently impacting their eligibility for consolidation. To address this challenge effectively, it is imperative to explore the adoption of a comprehensive definition of group entities that encompasses both horizontal and vertical structures. This comprehensive definition would facilitate the identification of companies with interconnected assets and liabilities. Objective analysis of factors such as control and ownership may be utilized to ascertain the entities that constitute the group.

It is imperative not only to establish a precise definition of group entities but also to consider the matter of authorized initiators for a consolidation application. The current avenues for applications, as outlined in sections 7, 9, and 10 for financial creditors, operational creditors, and corporate entities, would need to be reevaluated to incorporate provisions for consolidation when deemed necessary. In certain instances, it may be more appropriate for a resolution applicant to file for consolidation when the need arises. The resolution of these matters necessitates a clearly defined legislative framework that undergoes meticulous deliberation.

Adequate protection of creditors

During a consolidation process, creditors of solvent entities and small entities within a group often find themselves in a vulnerable position. This vulnerability reduces their motivation to cooperate with the process. Moreover, while consolidation aims to maximize value, it can sometimes lead to a redistribution of the base value, negatively impacting certain creditors.

To address these concerns, it would be crucial to ensure adequate protection for creditors throughout the consolidation process. The legal framework would need to include provisions that allow creditors to express their concerns before proceeding with consolidation. By incorporating these provisions, creditors would have a voice in the process, mitigating the risk of unfair prejudice resulting from consolidation.

For instance, Australian law adopts a practice wherein the assets and liabilities of group companies are pooled during liquidation. However, this consolidation is only implemented if all unsecured creditors of each company approve the liquidator's decision.[11] Similarly, in Japan, the concept of creditor consent for consolidation is present, emphasizing the importance of considering creditors' perspectives.

By incorporating such measures into the legal framework, the consolidation process would promote transparency, fairness, and creditor participation, ensuring that their interests are appropriately safeguarded.

Coordination between RPs

A critical challenge in group insolvency cases lies in the coordination between the RPs assigned to each entity within the group. Without a specific framework in place, these RPs may adopt different approaches and timelines for resolving their respective entities, hindering the overall resolution process.

To address this challenge, the proposed framework by the MCA suggests the appointment of a common Adjudicating Authority (AA) and Insolvency Professional (IP) for the corporate debtor (CD) and its related parties. This measure aims to facilitate effective communication and collaboration among the RPs, minimizing delays caused by a lack of coordination.

Enabling a common AA and IP for the CD and its related parties would promote a unified approach to resolution, allowing the RPs to align their efforts and share insights for the benefit of the entire group. By establishing a framework that fosters communication and encourages commonality in approach, the proposed changes seek to enhance the efficiency and effectiveness of the group insolvency resolution process.

Cross-border jurisdictional conflicts

Group insolvencies often involve entities operating in different jurisdictions, each with its own insolvency laws and regulations. Resolving jurisdictional conflicts and determining the appropriate forum for conducting proceedings could be a significant challenge. The framework would need to provide guidance on how to handle conflicts of laws, ensure cooperation between different jurisdictions, and establish mechanisms for resolving jurisdictional disputes efficiently.

Regulatory considerations

Group insolvency proceedings may intersect with various regulatory frameworks, including competition law, tax regulations, and sector-specific regulations. The framework would need to consider the interaction between insolvency laws and other regulatory regimes, ensuring consistency and providing guidance on potential conflicts or compliance requirements that may arise.

Priority of claims and distribution of assets

Determining the priority of claims and the equitable distribution of assets within a group insolvency can be complex, particularly when multiple entities are involved. The framework would need to provide clear rules and methodologies for determining the hierarchy of claims, ensuring fair treatment of creditors, and establishing transparent procedures for asset distribution. This would contribute to a more predictable and efficient resolution process.

Employee protection and employment-related claims

Group insolvencies can have significant implications for employees, including potential job losses and unpaid wages or benefits. The framework would need to establish mechanisms to protect employee rights, ensure timely payment of wages, and address issues related to severance, pension plans, and employment contracts. It would also need to consider measures to facilitate the re-employment or retraining of affected workers.

Valuation and assessment of group assets

Group insolvencies often involve complex corporate structures and interdependent assets. Accurately valuing and assessing the assets and liabilities of group entities can be challenging. The framework would need to provide guidance on valuation methodologies, require transparency in financial reporting, and ensure that experts with relevant experience are involved in the assessment process.

Intercompany transactions and related-party issues

In group insolvencies, intercompany transactions and related-party dealings can present challenges. The framework would need to consider issues such as avoidance transactions and include provisions to scrutinize and potentially set aside transactions that unfairly benefit certain entities or insiders at the expense of creditors.

Stakeholder engagement

The involvement and protection of various stakeholders, including employees, creditors, shareholders, and customers, is critical in group insolvency proceedings. The framework would need to consider enhancing stakeholder engagement, ensuring their voices are heard and their rights are safeguarded. Effective communication channels should be established to enable stakeholders to participate in decision-making processes and access relevant information.

Data accessibility and sharing

Access to accurate and timely information is essential for efficient group insolvency proceedings. The framework should establish mechanisms for collecting, aggregating, and sharing relevant data on group structures, financials, and liabilities. Implementing standardized reporting requirements and leveraging technology to enable data exchange will enhance transparency and facilitate informed decision-making by IPs.

Judicial cooperation and expertise

Judicial cooperation is vital in group insolvency cases, particularly when dealing with complex legal issues and conflicting laws. The framework should encourage the establishment of specialized courts or judges with expertise in group insolvency matters. This will ensure consistent interpretation and application of the framework's provisions and expedite the resolution process.

Mechanism for procedural consolidation

The absence of procedural coordination in group insolvency cases creates bottlenecks. Coordination involves synchronizing insolvency proceedings for a group without merging assets or changing rights and liabilities. The goal is efficient administration while preserving individual case integrity.

This lack leads to difficulties in determining interdependence of assets and liabilities. Addressing these issues requires a practical framework for consolidation, incorporating procedural and substantive elements. The recent *Videocon Case* decision provides guidance on substantive consolidation and also highlights the need for clarity and specific circumstances.

The framework for group insolvency cases should include provisions for both substantive consolidation and procedural coordination. Such a comprehensive approach would help in ensuring that the framework is accessible and adaptable to a wide range of group insolvency scenarios. By incorporating both mechanisms, it would address the need for consolidating assets and liabilities while also synchronizing the procedures of concurrent insolvency proceedings.

CONCLUSION

The creation and implementation of a comprehensive framework for consolidation in India presents a unique opportunity to draw from global best practices and tailor them to our needs to address the challenges of group insolvency. By integrating insights from past cases and analyzing the current framework, India can pioneer innovative solutions and become a global leader in this field.

Successful implementation of the framework depends on careful execution and incorporating feedback from stakeholders and experts. Continuous evaluation is crucial to make timely adjustments and ensure the framework remains efficient and aligned with industry needs. Timely resolution is paramount to prevent increased losses for stakeholders. The framework should prioritize expeditious handling without compromising quality, achieved through streamlined procedures and effective coordination.

In conclusion, India has an opportunity to lead by implementing a practical framework for group insolvency consolidation. By integrating insights, streamlining processes, addressing bottlenecks, unlocking value, and promoting transparency, India can become a global pioneer, benefiting the economy and setting a benchmark for others to follow.

[1] Report of the Working Group on Group Insolvency (2019), Ministry of Corporate Affairs, Government of India.

[2] Supra Note 1.

[3] Civil Appeal Nos. 9170-9172 of 2019.

[4] 2018 SCC Online NCLT 13182.

[5] *Ibid.*, para 82.

[6] Sinder Bothers, *INC In re 18- B.R 230* (Bankr.D.Mass.1982).

[7] 860 F.2d 515 (2d Cir.1988).

[8] 810 F 2d 270 (DC Cir 1987).

[9] Para 8.1.3, Company Appeal (AT) (Insolvency) No. 707 of 2019 in NCLAT, Delhi.

[10] Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016, Ministry of Corporate Affairs, Government of India, dated 18th January 2023.

[11] See generally: Sections 571 to 579L of the Corporations Act, 2001 (Australia).

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Group Insolvency: Relevance of Substantive Consolidation in Indian Context

- Vinod Kothari and Sikha Bansal

INTRODUCTION

Insolvency law has always to be aligned to economic realities; when it comes to solving the problem of corporate insolvencies, an economy cannot disregard the prevalent corporate structures. The design which corporates adopt to conduct business must, in fact, be one of the most critical factors while designing the insolvency laws. Thus, if group assets, contracts, technological assets, investments or intellectual or other business rights remain scattered across a complicated group of intertwined entities, an insolvency law framework that remains constrained by the bounds of 'legal entity' is unlikely to achieve the objective of ensuring preservation and, in case of liquidation, equitable distribution of corporate value for the benefit of stakeholders.

PROPAGATION OF GROUP STRUCTURES IN INDIA

Therefore, the key question to start is: Do Indian businesses have complex group structures, involving layers of entities, whether legally structured as subsidiaries or not? An OECD Report, prepared with significant inputs from the Securities and Exchange Board of India,[1] citing data collected from 4100 listed companies as of December, 2020, says that there are on an average 50 subsidiaries for listed companies forming part of NIFTY-50, a number which has tripled over the last 15 years. It goes further to say that there are 15 listed companies which have more than 100 subsidiaries, whereas there are some which have over 200. Further, out of the 100 largest listed companies by market capitalization, approximately 40 Indian listed companies had three or more layers of subsidiaries/step-down subsidiaries, surpassed only by Singapore and Malaysia among OECD countries.

If the numbers stated in the above survey are surprising, it must be submitted that these numbers do not incorporate (a) number of layers on the top of the listed entity, that is, the chain of holding companies or companies; (b) associates, as quite often, the shareholding may be split across several group entities with none of them having sufficient holding to be termed as holding company; (c) the chain of companies above or below a listed company where the chain is snapped by use of a chain-breaker, that is, an entity which itself is not a subsidiary of the listed entity, but owns or is owned by a vertical chain of entities.

The plausible economic reasons for existence of group structures are: efficiencies in operations, reduced dependence on external finances, and economies of scale. And as such, one would often see overlaps in asset use (e.g. asset of one entity being shared across group entities, or used as security against borrowings of entities), liabilities (group entities being joint obligors, third party security providers), common stakeholders (shareholders, directors, lenders, etc.) across group entities. However, such complex group structures have the potential to house complex web of transactions, thereby increasing the opacity of such structures and chances of wrongdoings, misconduct and lawlessness. Holding entities are most commonly employed to raise finance for group holdings, using pledge of operating companies' shares, and use such borrowings to finance the operating companies. It is also commonplace practice to have a group's brand or intellectual property owned by a promoter group entity. As there were many cases where group transactions were involved and/or put to question by the courts during insolvency proceedings.[2]

CONGLOMERATES VS. INTERDEPENDENT BUSINESS MODEL

Given such interlinkages and overlaps, if one entity goes into the red, it would potentially impact other group entities and their stakeholders. Say, if group entity A provided security for borrowings by group entity B, and B goes insolvent, then assets of A would be used to pay off the lenders of B. This way, the lenders of A may have to content themselves with a smaller share of the pie. The lenders may be a common set of lenders, or may be different. In fact, insolvency of one entity may have the potential of affecting the solvency of other group entities given the kind of interlinkages and dependencies.

Per contra, if a group of entities is working with interlinkages and deriving value from shared assets and interconnected business model, and one of the entities in the group undergoes insolvency whereas the other entities remain healthy, there will neither be a meaningful resolution of the ailing entity, as there may be stakeholder opposition from the healthy ones, nor does the insolvency of one of the entities seem just for its stakeholders. As such, it is important to look into the economic realities and think holistically about the insolvency resolution framework. The situation of a conglomerate, that is, different business verticals housed in different entities, is different, because each business vertical is an independent source of activity and value. However, an interdependent business model is one where one integrated business is housed across various entities. For instance, sourcing, marketing, ownership of some critical inputs, resources or technology, etc., of a single integrated business may be spread across entities and jurisdictions. In case of an interdependent business model, an enterprise-wide approach, rather than being delimited by the confines of legal entity, becomes important for the following inclusive reasons:

- First, the operations, resources, debts, and assets of companies within an interdependent business may be deeply interconnected, posing challenges in effectively resolving individual corporate entities and achieving optimal asset maximization as envisioned in the insolvency law.
- Second, lenders usually while providing debt consider the financial standing of the enterprise or group and not the corporate entity

alone, thus such market and economic realities cannot be overlooked. There is, of course, a contrary view: a creditor taking exposure on an entity is entitled to rely on the limited liability of the entity, and consolidation may lead to commingling of assets and assumption of liabilities of other entities, resulting in making a dent on limited liability. While lifting or piercing of corporate veil is an approach that has as long history as separation of legal entities, but that approach is expected to be a principle-driven approach rather than spasmodic.[3] The response to this contention may be as follows: substantive consolidation, wherever, ordered, has to be after considering all equitable grounds, and in particular, the creditors of a solvent entity cannot be put at par with those of an insolvent entity in the group. The relative ranking of the debts of solvent companies, and those moving from other insolvent companies in the group, may be that of fixed charges vs floating charges, with the former taking precedence (see discussion later under Case for Substantive Consolidation in India).

- Third, to prevent misuse of the present single-entity based framework where a parent company of a corporate debtor (CD) belonging to an enterprise may hide behind the corporate veil to protect its resources to the detriment of the creditors.
- Fourth, to achieve the objectives of the resolution process within a time-bound and in a cost-effective manner as resolution of various entities of a group separately involves disentangling assets and liabilities of highly interlinked group companies.

PROCEDURAL COORDINATION VS. SUBSTANTIVE CONSOLIDATION: TWO DIFFERENT APPROACHES TO GROUP INSOLVENCY RESOLUTION

There can be various approaches[4] to group insolvency depending upon the intended objective, namely, -

a. Extension of liability and contribution orders

b. Equitable subordination

c. Avoidance applications

d. Procedural coordination

e. Substantive consolidation

However, in the given context, the two approaches - procedural coordination and substantive consolidation become important.

Understanding procedural coordination and substantive consolidation

Procedural coordination, as the nomenclature implies, is a way of coordinating and synchronizing the procedural aspects of concurrent insolvency proceedings of entities belonging to a common group. Procedural coordination does not involve pooling of assets and liabilities of the group entities which are lying in the insolvency regime, and therefore, does not alter substantive rights or liabilities of parties. It may have a common Adjudicating Authority (AA), may be coordinated meetings of creditors, coordination among Insolvency Professionals (IPs), etc. To summarise, procedural coordination is limited to synchronising various aspects of the insolvency proceedings of group entities, so that there is no disjointed approach to the resolution. Thus, the individual entities in the group retain their separate legal identities, their separate insolvency estates, and their separate bodies of creditors even when their insolvency proceedings are being procedurally coordinated.

Procedural coordination presupposes that the group entities are also into insolvency; there is no question of pulling in solvent group entities in any coordinated group insolvency solution.

Substantive consolidation, on the contrary, is a mechanism pursuant to which all the assets and liabilities of the insolvent CDs belonging to the group are pooled so as to treat the same as a single entity insolvency resolution process. If circumstances warrant, even the assets and liabilities of solvent entities (also referred to as 'non-debtor entities') may be aggregated.

Basis above, if we carve out the differences between the two approaches, the same would broadly appear as follows -

Basis of distinction	**Procedural Coordination**	**Substantive Consolidation**
Purport	To only coordinate the 'procedures' relating to insolvency of each insolvent entity belonging to the group	To consolidate the assets and liabilities of all the insolvent entities in the group so as to treat them as 'one', and if financial and operational 'oneness' of entities may be proved, to aggregate solvent group entities as well.
Objective	To make the administration of insolvency proceedings against group entities easier and inexpensive	To ensure that enterprise value is not lost due to fragmented resolution of only some entities, leaving other entities behind. To ensure equitable treatment to creditors by commingling assets and value, which, in reality, belong to an interdependent enterprise.
Substantive right of creditors	Procedural coordination does not impact the substantive rights of the creditors	Substantive consolidation affects the substantive rights of the creditors

Principle of separate legal entity	Separate legal entity of each group entity is kept intact	The principle of separate legal entity is completely disregarded
Effect on inter entity claims	Inter entity claims remain unaffected	Inter entity claims vanish.
Nature of integration	Procedural coordination is more in the nature of 'business integration'	Substantive consolidation is more in the nature of 'asset integration'

CURRENT APPROACH OF THE CODE AND CONSIDERATION OF GROUP APPROACH

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is premised on legal entity approach. The same is true for insolvency laws of most other countries too. It is to be noted that group approach is not a part of the essential structure of the law - it is an exceptional situation, mostly on a voluntary basis or subject to inherent jurisdiction of adjudicating bodies. See discussion later on position in some select countries.

The realisation, that a group approach may be preferred over a single entity approach, has been made in several insolvency matters in India, namely *Videocon, Era infrastructure, Lanco, Educomp, Amtek, Adel, Jaypee and Aircel, etc.* Thus, a Working Group on Group Insolvency[5] submitted a Report in 2019 discussing both procedural coordination as well as substantive consolidation but recommended that the latter may be reserved for subsequent implementation after gaining some experience on the procedural coordination. However, the Report of Cross Border Insolvency Rules/Regulations Committee (CBIRC)-II on Group Insolvency,[6] in January, 2023, observed that substantive consolidation is a remedy resorted to in exceptional circumstances and the provisions governing substantive consolidation may not be provided in the Code at present. It preferred procedural coordination.

However, it would be relevant to see if the precedents applied in other countries (where the corporate structures might be completely different from the Indian counterparts) can be effectively superimposed in India. It would also be relevant to take note of global jurisprudence developed in this regard, and examine if, in light of the prevalent corporate structures in India and practical realities, whether substantive consolidation might be a feasible route in near future. Further, if at all, there are strong motivations for accepting substantive consolidation in the Indian context, it needs to be considered whether the framework has to come from the legislative text or jurisprudence alone may prove to be leading the law on the matter.

GLOBAL TRENDS IN DEALING WITH GROUP INSOLVENCY MATTERS

The concept of 'separate legal entity' is rooted deeply into the very concept of a 'company', regarding the company as a juristic person itself and not merely an aggregation of persons. Commonly, the classic ruling in *Salomon v. Salomon and Company, [1896] UKHL 1, [1897] AC 22* is seen as the first judicial recognition of the principle, and as the corporate form was transported from the UK to other parts of the world to eventually become the most common form of business, the concept is given credence in almost all the jurisdictions throughout the globe. However, Courts have consistently kept making inroads into the separation of legal entity, under various pretexts, known as lifting, piercing, side-stepping, glancing through the corporate veil etc. As global jurisdictions have continued to explore the seat of control, beneficial ownership, etc, there is an increasing realisation that corporate vehicles are mere instrumentalities, and it is entirely upto the ingenuity of the structurer to structure and propagate entities, which have an optical or formal separation, but really belong to the same enterprise.

The considerations for a group-wide approach may be diverse, but here, the topic under consideration is the insolvency framework. Hence, the authors discuss the trends in dealing with group insolvency matters in some of the jurisdictions across the globe.

USA

The development of jurisprudence on substantive consolidation has been rather uneven, with no clear signals from either the law or any Supreme Court ruling. Early rulings relied upon the extent of interconnection, but the test seemed to be whether all creditors will be benefited by consolidation. In a 1966 ruling, it was held that 'where the interrelationships of the group are hopelessly obscured and the time and expense necessary even to attempt to unscramble them so substantial as to threaten the realization of any net assets for all the creditors, equity is not helpless to reach a rough approximation of justice to some rather than deny any to all'.[7]

The 2005 ruling in *Re Owens Corning*[8] seemed to be a landmark, as it held that substantive consolidation is extreme (it may affect profoundly creditors' rights and recoveries) and imprecise, that this 'rough justice' remedy should be rare and, in any event, one of last resort after considering and rejecting other remedies (for example, the possibility of more precise remedies conferred by the Bankruptcy Code). It is notable that the ruling of the 3rd Circuit court in this case cheered a consortium of 43 banks, who were opposed to the lower court's order of consolidation, as that would have rendered nearly $ 2 billion of guarantees held by them meaningless.

It seemed, after the *Owens Corning* ruling, that substantive consolidation will become extinct. However, there have been several subsequent rulings where substantive consolidation has been ordered. In 2017, in *Clark's Crystal Springs Ranch, LLC v. Gugino (In re Clark)*, 692 Fed. Appx. 946, 2017 BL 240043 (9th Cir. July 12, 2017), the U.S. Court of Appeals for the Ninth Circuit ruled, opting for consolidation, that the remedy of 'substantive consolidation' is governed by federal bankruptcy law, not state law.

In *ADPT DFW Holdings, LLC*,[9] the Northern District of Texas Bankruptcy Court held that a lenient standard may be applied in deciding whether affiliated debtors with a large, complex corporate structure should be substantively consolidated. The court authorized the 'deemed consolidation' i.e., consolidation for the limited purpose of voting and distribution under the plan of 140 affiliated debtors.

In contrast to the substantive consolidation of debtors in a group, the Courts in the US have also examined the application of substantive consolidation of debtors with non-debtors, that is, entities where the creditors do not have any financial stake, and which may not be insolvent. Since, section 105(a) of the US Bankruptcy Code provides that a court 'may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions', some of the courts have held that the substantive consolidation of debtor entities with non-debtors is permitted under the broad power granted pursuant to said section.[10] However, others have taken a view that the substantive consolidation of debtors and non-debtors is inappropriate because the bankruptcy courts lack jurisdiction over entities which are not insolvent and therefore, should not simply drag unwilling entities that never chose to file for bankruptcy into a bankruptcy forum simply because it is expedient and will help one party or another. Also, substantive consolidation of debtors and non-debtors circumvents the stringent procedures and protections relating to involuntary bankruptcy cases as set forth in section 303 of the US Bankruptcy Code.[11]

The US Courts of Appeal in *Clark's Crystal Springs Ranch, LLC v. Gugino* (In re Clark), 692 Fed. Appx. 946, 2017 BL 240043 (9th Cir. July 12, 2017), also addressed the propriety of substantively consolidating debtor and non-debtor entities. The Court held that the Bankruptcy Courts retain equitable power to grant substantive consolidation notwithstanding Congress's amendment of the Code without codifying that power.[12]

UK

The case of *Re Collins & Aikman Europe SA* [2006] EWHC 1343 (Ch) is cited as an instance of coordinated proceedings. This was a case of administration rather than insolvency under the UK 1986 Act. The administration followed Chapter 11 proceeding against the parent entity in the USA. The UK Administrator carried consolidated proceedings against a group of 24 companies in 10 EU jurisdictions. Eventually, the entire group was sold as a going concern, saving jobs and value.

Celebrated author R M Goode,[13] highlighting the limited applicability of the substantive consolidation in the group insolvency matters, states:

> Much attention has been devoted in the recent years to ways in which it might be possible to treat a group as a single economic enterprise for insolvency purposes. This is not easy to achieve even if limited to procedural consolidation, which would treat the member of the group as one for the purpose of administration, while keeping the assets and liabilities separate. It is harder still, in policy terms, to effect substantive consolidation, involving pooling of assets and liabilities, for this interferes with the existing rights if creditors, in particular creditors of a group member having substantial assets who can legitimately argue that they dealt with that member and should not have their position impaired by consolidation if assets and liabilities with less well-placed members of the group In principle, a parent company is not liable for the debts of its subsidiary. It is only infrequently that English courts will be willing to pierce the corporate veil. It is rarer still to consolidate assets and liabilities; indeed the only case where this is likely to happen is where the assets and liabilities of the different companies within the group are so intermingled that it is impracticable to separate them. [Emphasis supplied]

ENTERPRISE GROUP INSOLVENCY UNDER EU LAW

The EU insolvency regulation incorporates a specific chapter, Chapter V, on insolvency of groups of companies. This regulation was recast in 2015 to incorporate the special group insolvency provisions.

This chapter in the EU insolvency regulations, dealing with the insolvency proceedings of the members of 'group of companies'[14] provides for cases where insolvency proceedings falling within the scope of the EU Insolvency Regulation are opened in relation to two or more members of a group of companies in more than one member state. These provisions however facilitate voluntary 'group coordination proceedings' (Article 61) wherein the insolvency practitioner has been given the right to object to their participation in the proceedings within a specified time period. The group coordination proceedings as discussed above can be initiated if the court must is satisfied that the opening of such proceedings is appropriate to facilitate the effective administration of the insolvency proceedings relating to the different group members, no creditor of any group member expected to participate in the proceedings is likely to be financially disadvantaged by the inclusion of that member in such proceedings and the group coordinator fulfils the requirements laid down under the regulations (Article 63). Here it is quite significant to note the provisions of Article 72 which provides that the 'group coordination plan' that identifies, describes and recommends a comprehensive set of measures appropriate to an integrated approach to the resolution of the group members' insolvencies shall not include recommendations as to any consolidation of proceedings or insolvency estates.

An inference that can be drawn from the above cited provisions of Chapter V of the recast EU Insolvency Regulations is that it neither provides for substantive consolidation nor procedural coordination but does mandate various forms of cooperation and communication between courts and insolvency practitioners and facilitates the coordination of proceedings by a range of means including the commencement of 'group coordination proceedings'.[15]

Despite these provisions, the findings seem to suggest that the coordination of proceedings has not been effective in practice. A statement released by an independent body, the Conference on European Restructuring and Insolvency Law,[16] states that in practical terms: some four years after the European Insolvency Regulation (Recast) became binding, not a single significant case of a cross-border group insolvency has been handled under the rules on group coordination proceedings.

UNCITRAL

Since the prime motive behind the insolvency regime in any jurisdiction across globe is to aim at resolving the state of insolvency of an insolvent debtor by devising a rescue plan for the same and if such rescue plan does not work out, push the entity into liquidation and distribute the liquidation estate equitably. However, in cases where the assets or operations of a corporate group are scattered across inter-connected entities, it is not possible to achieve a meaningful rescue without taking a group-focused approach. Also, the Michigan Journal of International Law[17] cites, 'International group insolvency poses a complex problem of an international character' that is to say devising and agreeing upon an effective legal international instrument to address the problem is a true challenge. Also, since various countries across the globe have contrasting and divergent views in dealing with the group issue, there exists a strong need for devising a group approach. UNCITRAL's work mainly relates to cross-border issues: hence, UNCITRAL has framed a Model Law on Enterprise Group Insolvency, 2019 (Model Law).[18]

The Model Law includes provision in relation to coordination and cooperation between courts, insolvency representatives and a group representative with respect to multiple insolvency proceedings concerning members of an enterprise group, devising of group insolvency solution for the whole or part of an enterprise group through a single insolvency proceeding commenced at the location where at least one group member has the centre of main interests (COMI), voluntary participation of multiple group members in that single insolvency proceeding for the purposes of coordinating a group insolvency solution for relevant enterprise group members. However, with respect to other mechanisms like provision for filing of joint application for initiating group proceedings, substantive consolidation etc., the Model Law is silent and inclusion of the same in the Statute has been left at the discretion of the enacting state.[19]

However, Part three of the UNCITRAL Legislative Guide on Insolvency Law (2012)[20] (Legislative Guide) discusses substantive consolidation as well. Para 111 of the Legislative Guide states that substantive consolidation would generally involve the group members subject to insolvency proceedings, but in some cases and as permitted by some insolvency laws, might extend to an apparently solvent group member. This might occur when the affairs of that member were so closely intermingled with those of other group members that it would be impractical to exclude it from the consolidation, where it would be beneficial to include it in the consolidation if further investigation showed it to be actually insolvent because of the intermingling of assets or where the legal entity is a sham or involves a fraudulent scheme.

Underlining the exceptional circumstances where substantial consolidation may be ordered, the Legislative Guide indicates that it might be appropriate to order substantive consolidation where there is no real separation between the group members and the group structure is being maintained solely for dishonest or fraudulent purposes. A further ground wherein the same can be ordered is where such consolidation leads to greater return of value for creditors, either because of the structural relationship between the group members and their conduct of business and financial relationships or because of the value of assets common to the whole group, such as intellectual property in both a process conducted across numerous group members and the product of that process.[21]

DEVELOPMENT OF JURISPRUDENCE IN INDIA

The concept of 'group insolvency' in India was first witnessed in *Venugopal N. Dhoot v. State Bank of India*[22] where multiple companies of the Videocon group were undergoing corporate insolvency resolution process (CIRP). It was prayed before the AA to consolidate all the insolvency proceedings of companies belonging to Videocon group. The AA rejected the plea of consolidation but directed all the applications insolvency proceedings to be placed before one bench of National Company Law Tribunal (NCLT), thus recognizing one of the key elements of 'Procedural Coordination' i.e., Single AA. Subsequently, Mumbai bench of NCLT in *State Bank of India & Anr. v. Videocon Industries Ltd. & Ors.*,[23] the insolvency proceedings of 13 out of 15 companies of the Videocon group were consolidated by way of 'Substantive Consolidation' resulting in pooling together of all the assets and liabilities of the group companies. The parameters taken into account by the NCLT for considering the consolidation are - (a) common control; (b) common directors; (c) common assets; (d) common liabilities; (e) inter- dependence; (f) interlacing of finance; (g) pooling of resources; (h) co-existence for survival; (i) intricate link of subsidiaries; (j) intertwined accounts; (k) inter-looping of debts; (l) singleness of economics of units; (m) common financial creditors; and (n) cross shareholding.

In *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. & Ors.*,[24] the National Company Law Appellate Tribunal (NCLAT) initiated group insolvency of five CDs on whose land a township was to be developed by them to facilitate the successful completion of the project. The Appellate body directed continuation of CIRP against the CDs under the supervision of one Resolution Professional (RP), thus adopting procedural coordination to deal with group insolvency in the instant case.

In *Axis Bank Limited v. Lavasa Corporation Limited,*[25] NCLT in order to maximize the assets of the CDs which included Lavasa Corporation Limited and its subsidiaries, initiated a CIRP of the group companies which were undergoing insolvency proceedings. It also appointed a single RP for the consolidated insolvency proceedings. The tribunal relied on its decision in *State Bank of India & Anr. v. Videocon Industries Ltd. & Ors.* to determine the inter-linkages and intertwining of the group companies of Lavasa. Similarly, in *Radico Khaitan Ltd v. Bt & Fc Pvt Ltd And Ors.,*[26] NCLAT ordered consolidation of CIRP of two companies which the tribunal found to be inextricably interlinked and intertwined.

PROPOSALS IN RELATION TO INCLUSION OF LEGAL FRAMEWORK AROUND GROUP INSOLVENCY IN INDIA

Currently, looking at the inter-linkages in the corporate groups and the absence of any expressed principles dealing with resolution of corporate groups in the present framework, MCA in the month of January, 2023 came up with a discussion paper[27] proposing amendments in the Code so as to include expressed provisions dealing with the 'Group Coordination' process in order to account for higher possibility of revival, improved procedural coordination and better value realisation.

The discussion paper indicates the inclusion of provisions relating to procedural coordination for insolvency resolution/liquidation of group entities falling in the ambit of this Code that is to say appointing a common AA and common RP in cases where there exist related parties in the nature of holding, subsidiary or associate companies of the CD, or, a subsidiary of a holding company to which the CD is a subsidiary. It has been further envisaged that the committee of creditors (CoC) of two or more separate CDs may file an application seeking cooperation and coordination of the CIRPs/liquidation concerning the CD.

Therefore, it becomes quite clear that currently only the provisions related to procedural coordination is being considered to be included in the Code and the question of substantive consolidation of insolvent CDs in a group will solely hinge upon the discretion of the AA.

Draft Part ZA

The rapid spread of globalization has given birth to many multinational corporations that make their way even out of the national boundaries of a country leading to an almost borderless commercial relationship with entities across the globe. This extended commercial relations with overseas entities also leads to spread of debtors and creditors in different jurisdictions as well. Therefore, while the authors are talking about a group insolvency framework, the discussion around a legal framework dealing with cross-border group insolvency cannot be overlooked. In this regard, the CBIRC was engaged to make recommendations in order to operationalize the group insolvency part in the context of IBC based on the review of recommendations contained in Model Law,[28] a model legislation providing a comprehensive framework for domestic as well as cross border insolvency of enterprise groups.

The CBIRC in its Report discusses that since presently, the legal framework around 'Cross- Border Insolvency' regime in India is not operational, the inclusion of group insolvency framework from a cross border angle may be included in IBC at a later stage after taking guidance from the successful implementation of the single entity cross-border insolvency laws in India which has already received a green signal pursuant to the Union Budget 2022-23[29] wherein it was announced that necessary amendments in the Code will be carried out to enhance the efficacy of the resolution process and facilitate cross border insolvency resolution.[30]

The draft group insolvency framework (Draft Part ZA), prepared on the basis of the recommendations of CBIRC defines group as two or more CDs that are interconnected by control or significant ownership and includes a holding company, a subsidiary company and an associate company of a CD, as defined under Companies Act, 2013. The Draft Part ZA provides that a group coordination proceeding aiming at devising a group strategy for resolution of insolvent CDs in a group may be initiated upon an application filed before the AA. Such an application can be filed before the AA provided the same is approved by at least 66% votes in favour by the CoCs.

Upon admission of such an application, any member of the group which is under the ambit of IBC, may inform the group coordinator for performing in the process if the same is approved by 66% votes in favour by the

CoCs or by the Liquidator upon consultation with the stakeholders, as the case may be. Here, it will be interesting to note how a strategy for dealing with the crisis can be devised if one CD is in the insolvency resolution stage and the other is in the liquidation stage.

CASE FOR SUBSTANTIVE CONSOLIDATION IN INDIA

As discussed above, provisions are proposed to be added in the Code for procedural coordination; such provisions are there in several jurisdictions. However, the reality of corporate groups is distribution of wealth across different entities. The scenario is quite often indicative of movie flicks where a top-secret chamber is to be opened with a combination key, parts of which are kept at different places. In most real-life cases, there are multiple resources, contracts or concessions that must be needed to keep an enterprise going, and they lie at different places. It is also quite commonplace to systematically create sources of profits outside the entity using schemes of arrangement, related party transactions, etc. Provisions seeking avoidance of contracts or transfers have their own limitations, both in terms of time and scope.

Substantive consolidation, on the other hand, is intended to result into an enterprise-wide solution and will potentially result in value maximisation for the creditors of each of the entities within the enterprise.

Some possible points for consideration for the proposed substantive consolidation model in India may be as follows:

a) Explicit statutory basis or judicial discretion

Should provision permitting substantive consolidation be coded into the statute or should the same be a part of the inherent jurisdiction of the adjudicating bodies?

There are scanty examples of either statutory provisions for substantive consolidation, or a judicial authority searching for statutory basis for exercise of such powers. There has been a US ruling[31] where the bankruptcy court searched for the powers of substantive consolidation in the inherent powers of the bankruptcy court. However, substantive consolidation is always a 'facts and circumstances' ruling which is given only if the facts of the matter warrant the same. Since it will be impossible to list out the circumstances in which such a ruling may be warranted, hardcoding the circumstances or the indicators for consolidation in the law may neither be necessary nor advisable.

Therefore, the law may provide for procedural coordination, with an exception such as 'unless, for reasons to be recorded in writing in its order, the AA orders substantive consolidation', etc.

b) Identification of the nucleus of economic activity

The first key question may be identification of the 'COMI' or the centre of main operations. For identification of entities that may appropriately be taken as satellite entities, this nucleus of the enterprise needs to be identified. If the nuclear entity is insolvent, then the group insolvency approach may pull in solvent satellite entities. However, *vice versa* is not possible. The nuclear entity is the one which is typically listed or has multiple stakeholders and creditors, is the entity where the main commercial operations are housed, is widely known as the flagship entity. On the other hand, the satellite entities are the subsidiaries, associates, promoters or promoter group entities, or hold some of the assets, intellectual properties or resources which are used by the main entity. The satellite entities draw their value from the main entity.

The definition of a 'COMI' though not expressly provided but can be based on factors such as the location of the CD's assets; books of account; directors and senior management; the CD's creditors; the execution of contracts and applicable law to key contracts and disputes; where financing was organized or authorized, or from where the cash management system was run; primary bank account; and purchasing and sales policy, staff, accounts payable and computer systems were managed.[32]

c) Potential unfairness to creditors of solvent entities

It is a settled principle of substantive consolidation that if the main entity in an enterprise group is insolvent, the consolidation process may result in pulling the solvent entities into insolvency as well. To evince the understanding, one may refer to the case of *Lassman v. Cameron Constr. LLC (In re Cameron Constr. & Roofing Co.),*[33] *re Logistics Information Systems, Inc., Gray v. O'Neill Props. Group, L.P. (In Re Dehon, Inc.), No. 02-41045, 2004 WL 2181669, at *3 (Bankr. D. Mass. Sept. 24, 2004)* etc.

Para 111 of Part three of the Legislative Guide has already been cited above. Here, the key question is, if solvent entities are treated as insolvent, and their assets and liabilities are commingled with those of the insolvent entity, how are the interests of the creditors of the solvent entities protected?

In this context, Part three of the Legislative Guide provides that the rights and priorities of a creditor holding a security interest over an asset of an enterprise group member subject to an order for substantive consolidation should, as far as possible, be respected in substantive consolidation, unless the secured indebtedness is owed solely between enterprise group members and is extinguished by an order for substantive consolidation or it can be determined that the security interest was obtained by fraud in which the creditor participated or is subject to avoidance.[34]

However, the easy answer to this concern is the time-tested distinction between fixed and floating charges in common law. Fixed charge is charge over specific assets; floating charge is the charge over the value left after satisfying any fixed charges. Analogically, the specific creditors of the solvent entity have a claim over the assets of that entity, and that claim must be given priority. The residual assets of the solvent entity, after satisfying all secured and unsecured claims of the solvent entity, may be used for meeting any claims of the insolvent entity or entities. That is to say, it is only the surplus from solvent entities that will be added to the bankruptcy estate of the insolvent entities. This value, but for the adding to the bankruptcy estate of the insolvent entities, would have accrued to the shareholders of the solvent entities - therefore, the creditors of the insolvent entity are being given priority only over the shareholders.

d) Potential unfairness to shareholders of solvent entities

There is yet another formidable challenge: the unfairness of substantive consolidation to the shareholders of the solvent group entities. The structure suggested above subordinates the shareholders of the solvent entities to the creditors of the insolvent entities, thus digging quite a few shovels into the value accruing to the shareholders of the solvent entities. These shareholders may be public as well. Legitimate investors, who invested in the residual assets of the solvent entities, cannot be put below the claims of creditors with whom the solvent entity never contracted.

Here, the power of substantive consolidation has to be exercised very cautiously. First of all, if the solvent entities are listed companies or companies with wide public holdings, such entities should not be added for the purpose of substantial consolidation. It is important to note that the power of substantive consolidation is technical unification of what is otherwise really one. That is, in a way, substantive consolidation removes the limit of legal entity that was only formal or artificial, and in reality, the enterprise was operating as one.

Alternatively, the AA may opt for a majority-of-minority vote and seek the consensus of the shareholders.

e) Adjudication and insolvency administration, etc

In case of insolvency proceedings involving an enterprise group, the issue with respect to identification of the AA having jurisdiction over the matter also becomes significant to address.

For initiating substantive consolidation, application may be filed before any AA having territorial jurisdiction over one of the CDs in respect of whom the application is being made and post admission of such an admission, all proceedings related to CDs belonging to such an enterprise group may take place under the same AA. Further, to facilitate the same, all pending applications and proceedings in respect of a group member should be transferred to the AA that is the first to admit an application for triggering an insolvency resolution process in respect of any CD belonging to the group.[35] The common AA herein, may appoint common IP(s) to carry out the group proceedings.

CONCLUDING REMARKS

The case of procedural coordination has been well accepted in several jurisdictions and based on the MCA discussion paper dated January 18, 2023,[36] it is quite likely that the same may soon be coded into the law or the regulations. However, procedural coordination will not result into much value, as there may be several solvent entities in the enterprise group, and these will escape the reach of the insolvency proceedings. The whole purpose of group insolvency is to break through the barriers of legal entities to look at the enterprise as the source of value and not the entity/entities.

In the past, AA as well as Appellate bodies in India have ordered substantive consolidation in several cases, but the downside of explicit legislation permitting coordination should not be to strike through the possibilities of substantive consolidation. Hence it is very important to preserve judicial discretion to order substantive consolidation, for which the article has given both arguments, as well as answers to concerns.

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[1] OECD(2022), “ Company Groups in India”.

[2] *Yadubir Singh Sajwan & Ors. v. M/s. Som Resorts Private Limited*, Company Petition No. (IB)-67(ND)/2022; *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*, Civil Appeal nos.9402-9405 of 2018 etc.

[3] *Prest v. Petrodel Resources Ltd.* [2013] UKSC 34, [2013] 2 AC 415.

[4] Kothari V. and Bansal S., “Entity Versus Enterprise: Dealing with Insolvency of Corporate Groups”.

[5] Report of Working Group on Group Insolvency, 2019.

[6] Report of CBIRC-II on Group Insolvency, December, 2021.

[7] *Chem. Bank. N.Y Trust Co. v. Kheel, 369 F.2d 845, 847* (2d Cir. 1966).

[8] *In re Owens Corning* (2005), United States Court of Appeals, Third Circuit, No. 04-4080.

[9] *In re ADPT DFW Holdings, LLC*, et al., Case no. 17-31432-SGJ-11.

[10] *Donald R. Lassman v. Cameron Construction LLC (In re Cameron Construction & Roofing Co., Inc.) (Bankr. D. Mass. 2016), Simon v. ASIMCO Techs., Inc. (In re Am. Camshaft Specialties, Inc.), 410 B.R. 765, 786 (Bankr. E.D. Mich. 2009), In re S&G Fin. Servs., 451 B.R. 573, 579–82 (Bankr. S.D. Fla. 2011)* etc.

[11] *In re Pearlman, 462 B.R. 849, 854 (Bankr. M.D. Fla. 2012), Helena Chem. Co. v. Circle Land & Cattle Corp. (In re Circle Land & Cattle Corp.), 213 B.R. 870, 877 (Bankr. D. Kan.*

1997), Official Comm. of Unsecured Creditors v. Archdiocese of Saint Paul & Minneapolis, 562 B.R. 755, 762 (D. Minn. 2016) etc.

[12] Day J. (2017), "Ninth Circuit: Federal Law Governs Substantive Consolidation, and Supreme Court's Siegel Ruling Does not bar Consolidation of Debtors and Non-debtors", *Mondaq,* November 22.

[13] Principles of Corporate Insolvency Law, Fifth edition, pp. 30-31.

[14] Clause 13 of Article 2 defines "group of companies" as a parent undertaking and all its subsidiary undertakings.

[15] Article 56 to 58 of the EU Insolvency Regulations.

[16] CERIL Statement 2021-22 on EU group coordination proceedings.

[17] Mevorach I. (2019), "A Fresh View on the Hard/ Soft Law Divide: Implications for International Insolvency of Enterprise Groups", Michigan Journal of International Law, Issue 3, Vol. 40.

[18] UNCITRAL Model Law on Enterprise Group Insolvency.

[19] UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment.

[20] UNCITRAL Legislative Guide on Insolvency Law, Part three: Treatment of enterprise groups in insolvency.

[21] *Ibid.*, para 112-114.

[22] In the matter of *Venugopal N. Dhoot v. State Bank of India & Ors.,* CA-1022(PB)/ 2018, Order dated 24th October, 2018.

[23] MA 1306/2018 in CP No. 02/2018 & other company petitions.

[24] In the matter of *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Ltd.*, CA (AT)(Insolvency) No. 377 of 2019.

[25] In the matter of Lavasa Corporation Limited, CP 1765/IB/NCLT/MB/2018, order dated 26th February, 2020.

[26] *Radico Khaitan Ltd v. Bt & Fc Pvt Ltd and Ors,* CA (AT) (Insolvency) No. 919/ 2020, order dated 26th March, 2021.

[27] MCA Discussion paper dated 18th January, 2023.

[28] Supra Note 18.

[29] Budget (2023-2024) Speech of Hon'ble FM, Nirmala Sitharaman, 1st February, 2023.

[30] *Ibid.*, p. 76.

[31] *In re Cyberco Holdings, Inc.*, 431 B.R. 404 (Bankr. W.D. Mich. 2010).

[32] Report on the rules and regulations for cross-border insolvency resolution, p. 54, June, 2020.

[33] *Lassman v. Cameron Constr. LLC* (In re Cameron Constr. & Roofing Co).

[34] Supra Note 20, para 121 to 124.

[35] Guidance drawn from the recommendations provided in the CBIRC-II Report on Group Insolvency (Page 37, box 6).

[36] Supra Note 27, para 12.3.

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Cross-border and Group Insolvency Proceedings – The Way Forward

- Ranjith Krishnan and
Usha Ganapathy Subramanian

INTRODUCTION

When an entity becomes insolvent, it has implications on various stakeholders – lenders and suppliers may not be able to recover their dues, employees may lose jobs, shareholders may see their investments eroding in value, customers may face delays or defaults on their orders, and if the entity is huge enough, its insolvency could snowball into a crisis. An effective insolvency resolution framework becomes a *sine qua non* for stopping the snowball from becoming an avalanche, for salvaging the value of the business and for restoring a semblance of normalcy to the operations. And time is of the essence when it comes to ensuring business continuity and protecting stakeholders' interests. In this background, the Insolvency and Bankruptcy Code, 2016 (IBC/Code), has been a game changer in resolving insolvency by providing a defined time frame, clear provisions on moratorium and by involving Insolvency Professionals (IPs) who are well-equipped to handle insolvency.

GLOBAL AND DOMESTIC MEASURES FOR CROSS-BORDER AND GROUP INSOLVENCY PROCEEDINGS

As businesses become globalized with presence in various countries, the cross-border impact of an enterprise's insolvency needs to be looked into and addressed. This can be done through international co-operation and providing for such matters in the local insolvency resolution legislations. Internationally, Part Three of UNCITRAL Guide on Insolvency Law (adopted on July 1, 2010),[1] the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI) (adopted on July 15, 2019)[2] and the EU Regulation 2015/848 on Insolvency Proceedings (recast) (issued on May 20, 2015)[3] are the reference points for this purpose.

In November, 2017, the Ministry of Corporate Affairs of the Government of India constituted the Insolvency Law Committee (ILC) and in its October, 2018 Report,[4] ILC recommended the adoption of UNCITRAL Model Law on Cross-Border Insolvency (MLCBI) with some modifications to be inserted as Part Z as part of the IBC. In recent years, it has been observed that an enterprise's insolvency could have an impact on other businesses and especially, its group entities. To explore more on this, a Working Group on Group Insolvency was constituted, which submitted its Report on September 23, 2019, recommending various measures for resolving group insolvency to be implemented in stages starting with companies in domestic groups and slowly evolving to include matters of cross-border insolvency after observing the efficacy of the domestic group insolvency processes.[5] Following these, the Cross-Border Insolvency Rules/Regulations Committee (CBIRC) was formed on January 23, 2020 which submitted its first Report on June 15, 2020[6] containing framework for cross-border insolvency. On February 21, 2020, its terms of reference were expanded to include the MLEGI and to make recommendations on resolution of group enterprises, following which it furnished its Report in December, 2021.[7] This article takes a look at the recommendations of the Committees in respect of cross-border insolvency and group insolvency.

CROSS-BORDER INSOLVENCY

ILC recommendations

With reference to the major aspects of ILC's Report submitted in October, 2018, the present situation is that sections 234 and 235 of the IBC provide for an *ad-hoc* mode of resolving cross-border insolvency by permitting entering into bilateral agreements with countries and issuing letters of request to a country outside India in certain cases, but these are fraught with delays. In order to overcome the limitations of the present framework, the Report recommended the adoption of MLCBI with carve-outs. The reasons for adopting MLCBI with carve-outs are - aligning with best global practices, increased co-operation with foreign courts and tribunals, providing flexibility and respect to domestic insolvency laws and protection of domestic interest in case of actions contradicting domestic policy. The Report then proceeds to discuss the adoption of MLCBI with carve-outs under the headings: general provisions, access to foreign representatives, recognition of a foreign proceeding and relief, co-operation with foreign courts and foreign representatives, and concurrent proceedings – the four key elements emerging as access, recognition, coordination and cooperation.

Access

'Access' refers to the access provided to the foreign IPs and foreign creditors to domestic courts to enable them to initiate insolvency proceedings against an Indian debtor. While direct access by foreign creditors is already present, the Committee recommends a suitable framework for enabling access by foreign IPs. While some countries like UK and Singapore permit foreign representatives to directly access their courts without requiring further registration or other procedures as envisaged under MLCBI, the US has granted such access only after recognition of the foreign proceeding. In India, the Committee has recommended a more conservative approach of permitting such foreign representatives through the domestic IPs. Foreign representatives may be subject to the Code of Conduct and penalty provisions as applicable for the domestic IPs. Foreign representatives can initiate domestic insolvency proceedings without opting for recognition of the foreign proceeding. Further, they can participate in domestic proceedings based on the extent of access granted.

To enable access, under Part Z, the definition of corporate debtor (CD) needs to be amended to include foreign companies too. Pursuant to this, to avoid dual regime, the Committee proposed that the overlapping provisions may be removed under the Companies Act, 2013 under section 375(3)(b) which provides that an unregistered company, including a foreign company, may be wound up under the Act. The Committee also recommended that certain entities may be excluded from the application of the provisions as the Model Law envisages like in the case of banks and insurance entities as these entities may require special considerations in the insolvency resolution process. While applying for recognition of a foreign proceeding, the Model Law provides that the proof of existence of foreign proceeding together with the appointment of the foreign representative along with details of foreign proceedings shall be filed and provides that legalization of documents may be dispensed with. The Committee has made a small change here with respect to submission of details of both foreign and domestic proceedings. As far as access by domestic IPs to foreign courts goes, there is no prohibition at present on such matters and this may be encouraged through suitable regulations made by the Insolvency and Bankruptcy Board of India (IBBI). The Adjudicating Authority (AA) under Part Z will be the benches of National Company Law Tribunal (NCLT) as may be notified by the Central Government.

Recognition

'Recognition' refers to recognition of foreign insolvency proceedings by Indian courts and grant of appropriate reliefs and remedies based on such recognition. Here foreign proceedings are categorized as 'main' or 'non-main' depending on the principle of Centre of Main Interests (COMI). If the debtor's COMI is in the foreign country, the proceedings are 'main' proceedings and automatic relief will be made applicable here in respect of such proceedings like moratorium and powers of the foreign representative over the debtor's assets. If the debtor has an establishment here based on carrying on non-transitory economic activity, they are 'non-main' proceedings and providing of relief will be at the Court's discretion. The Committee has recommended that the decision on recognition shall be made by the AA within 30 days and another 30 days may be taken in case the decision has not been arrived at in the first 30 days. As per MLCBI, the decision 'shall' be granted once the criteria with respect to the definitions of foreign proceeding and foreign representative are satisfied together with the public policy criteria. The Committee also recommends that the recognition or relief may be denied in cases where they are manifestly opposed to public policy as provided in MLCBI. The term 'manifestly' is recommended to be retained by the Committee to denote that the term public policy should be given a restricted meaning and this provision should be used only under exceptional circumstances. The Committee also has recommended that the Central Government should be given an opportunity of being heard in such cases together with a power to make *suo motu* applications to the AA in such cases.

Determination of COMI is central to cross-border legislation as in case of a foreign proceeding in a jurisdiction in which the CD has COMI, it will be treated as a main proceeding and the relief will be automatic. The foreign main proceeding will be the one to manage the insolvency of the CD regardless of its presence in other countries. As per the MLCBI, the registered office will be the COMI unless proved to the contrary – a rebuttable presumption is made here. However, it will be up to the AAs to question the presumption in suitable cases to prohibit forum shopping measures. In addition to retaining these aspects, the Committee has decided that a look-back period for relocation of registered office in the past three months may be adopted. To refute the presumption of COMI, the factors suggested by MLCBI have been accepted by the Committee – where central administration of the debtor takes place, and which is readily ascertainable by creditors. A list of indicative factors such as those provided in the UNCITRAL Guide to Enactment – such as location of books and records, location where financing was organized or authorized, location of employees, location of cash management system, etc. for consideration by the AA may be provided by way of subordinate legislation i.e., Rules by the Central Government.

Cooperation and Coordination

'Cooperation' refers to cooperation between foreign and domestic courts and IPs inter-se and between domestic professionals and foreign courts. 'Coordination' refers to concurrent commencement of insolvency proceedings in two or more countries through increased cooperation.

Other aspects in the October, 2018 Report

In respect of reciprocity, UNCITRAL itself has given flexibility to the nations to decide not to incorporate reciprocity provisions or to incorporate such provisions in varying degrees. The Committee here has recommended that the model may initially be adopted on a reciprocity basis. This is only for Part Z and not for the rest of IBC, thereby retaining the right of foreign creditors to initiate and file claims in domestic insolvency proceedings irrespective of reciprocal arrangements with the governments of their countries.

The present sections 234 and 235 of IBC are proposed to be amended to apply only in respect of individuals and partnership firms, as the matters relating to CDs will be incorporated in Part Z.

The Committee's recommendations also include matters on interim relief, relief on recognition – in case of foreign main proceeding, the mandatory relief being moratorium under the domestic insolvency laws i.e., moratorium on the same lines as section 14 of the IBC may be inserted in Part Z. However, in line with MLCBI, the Committee has also recommended that the moratorium does not affect the right to commence individual actions against the CD to the extent necessary to preserve claims against the CD or the right to file domestic insolvency proceedings against the CD or the right to participate in such proceedings. The Report also discusses the discretionary relief available at the discretion of the courts for foreign main and non-main proceedings. Here the committee is of the view that discretionary relief should be provided only where the necessity is clearly established, and domestic creditors are protected and must be sparingly used.

The Committee also made recommendations on aspects involving avoidance actions, and on cooperation with foreign courts and foreign representatives. The Committee also recommended that there should be an appropriate authority to assist the AA in communications with foreign courts. On coordination of concurrent proceedings, the Committee has accepted the MLCBI provision that if foreign main proceedings are recognized, domestic proceedings may be started in so far as they relate to assets in India. In line with MLCBI, the Committee also recommended that instead of the test of insolvency, commencement of a foreign main proceeding may be taken as the proof of default for initiating corporate insolvency resolution process (CIRP) under IBC.

CBIRC recommendations

The terms of reference of CBIRC are to recommend measures to make way for a smooth operationalization of the recommendations of ILC for insertion of Part Z in IBC. The following are the key recommendations of CBIRC in its Report dated June 15, 2020:

a) The CBIRC has recommended that Part Z shall not be made applicable to Financial Service Providers which are notified by the Central Government under section 227 of the IBC. Part Z shall not provide for exemptions to any other classes of companies.

b) In respect of applicability of the provisions of IBC per se, anomalies may arise from non-applicability to foreign limited liability entities. The Committee recommends that the provisions of IBC should be made applicable to those entities having limited liability and incorporated outside India and having an establishment, as defined in Part Z, in India.

c) The CBIRC has also recommended that in respect of cross-border proceedings of Indian companies, the respective NCLT Benches having jurisdiction will handle the matters, and in respect of entities incorporated outside India, it will be the Principal Bench at New Delhi.

d) In respect of access to domestic insolvency proceedings by foreign representatives, a minimalistic authorization process must be followed by IBBI. A principle-based Code of Conduct may be applied to foreign representatives in Part Z proceedings and IBBI may be empowered to deal with matters of misconduct and disciplinary hearings against such representatives.

e) In respect of access by domestic IPs to foreign proceedings, since they are allowed currently, all that is recommended in this area is that the IP should inform such assignments to IBBI.

f) CBIRC also has made recommendations in respect of manner of giving notice to foreign creditors during insolvency resolution.

g) Determination of COMI: Here the CBIRC has taken a different view from that of the earlier ILC. Whereas ILC recommended that where the registered office as COMI is rebutted, it must be seen what the identifiable place of central administration is and if this cannot be determined, other factors may be looked into, CBIRC opines that other factors are as much important as the identifiable place of central administration because they affect the determination of such a place too. It also recommends that the date of commencement of foreign proceeding shall be the date for determining COMI.

h) CBIRC has also made an indicative list of reliefs in respect of a recognized foreign proceeding.

i) CBIRC has also recommended that a foreign representative may make an application for cooperation under Part Z without having the foreign proceeding recognized. However, in such cases, the AA shall not grant any reliefs which may be granted only in case of recognized foreign proceedings. It further recommended that an online application form be made available for applying for recognition under Part Z or cooperation under Part Z and for interlocutory applications, along with fees to be determined by the Central Government.

The Report is divided into three main parts, the first dealing with the typology of cases, the second in respect of specific issues for consideration by the Committee and the third in respect of augmenting the capacity of NCLT and IBBI to handle cross-border insolvency proceedings. The present article shall focus on the broad matters covered under the first part of the Report i.e., typology of cases as this will give a full picture of the scope of the provisions under Part Z.

The Committee has attempted to arrive at a typology of cases to determine the point of trigger of cross-border provisions under Part Z, and to determine which aspects of access, recognition, cooperation and coordination will be applicable to each case, and to arrive at a structure of rules and regulations to be made applicable in respect of different sequencing of proceedings – i.e., if foreign proceedings commence before domestic and vice-versa and when they commence concurrently.

The typology of cross-border cases relevant for the Indian insolvency proceedings are as per the table given below:

Table 1: Typology of cross border cases relevant for the Indian insolvency ecosystem

Debtor company	Case types
Indian company	1. Indian proceeding (under IBC), 2. Only foreign proceedings, one or many, 3. Concurrent proceedings i.e. Indian proceeding + one or more foreign proceedings
Foreign company	1. Domestic proceedings in the debtor company's home jurisdiction, 2. Indian proceeding, 3. Foreign proceeding in a jurisdiction outside India and outside the home jurisdiction of the debtor company, and 4. Concurrent proceeding, i.e. Indian proceedings + domestic proceeding or one or more foreign proceedings

Source: Typology of Cases by CBIRC, CBIRC Report, June, 2020.

The following tables show the matrix of the case types with the four elements - access, recognition, cooperation and coordination:

Table 2: Applicability of Part Z principles to Indian company with foreign assets and liabilities

Case type	FA/FL[1]	Recognition	Access	Cooperation	Coordination
Only Indian proceeding (IBC)	Both FA and FL exist	Of IBC proceeding by foreign court (as main)	For Indian IP to the foreign jurisdiction	Between: (1) NCLT and foreign court, and (2) foreign court and Indian IP	-
	Only FA exist, no FL	Of IBC proceeding by foreign court (as main)	For Indian IP to the foreign jurisdiction	Between: (1) NCLT and foreign court, and (2) foreign court and Indian IP	
	Only FL exist, no FA	-	-	Between: (1) Foreign court and Indian IP	
Only Foreign pro-ceeding	FA and/or FL exist	Of foreign proceeding by NCLT (as main or non-main)	(1) For foreign representative to India (2) For Indian creditors to the foreign proceeding	Between: (1) NCLT and foreign court, and (2) NCLT and foreign representative	
Concurrent proceeding (Indian+ Foreign)	FA and/or FL exist	(1) Of Indian proceeding offshore, and (2) Of foreign proceeding in India (decision on which is main)	(1) For Indian RP to foreign jurisdiction, (2) For foreign rep-resentative to India, and (3) For Indian creditors to the foreign proceeding	Between: (1) NCLT and foreign court, (2) foreign court and Indian IP, (3) NCLT and foreign representative, and (4) Indian IP and foreign representative	Between Indian and foreign proceedings

[1]*FA: Foreign Assets; FL: Foreign Liabilities*

Source: CBIRC Report, June, 2020

Table 3: Applicability of Part Z principles to Foreign company with Indian assets and liabilities

Case type	IA/IL[1]	Recognition	Access	Cooperation	Coordination
Only domestic proceeding (in home jurisdiction)	Both IA and IL exist	Of domestic proceeding by NCLT (as main)	(1) For foreign representative to India, and (2) For Indian creditors to the domestic proceeding	Between: (1) NCLT and foreign court, and (2) NCLT and foreign representative	-
	Only IA exist, no IL	Of domestic proceeding by NCLT (as main)	For foreign representative to India	Between: (1) NCLT and foreign court, and (2) NCLT and foreign representative	-
	Only IL exist, no IA	-	For Indian creditors to the domestic proceeding	-	-
Only foreign proceeding	Both IA and IL exist	Of foreign proceeding by NCLT (as main or non-main)	(1) For foreign representative to India, and (2) For Indian creditors to the foreign proceeding	Between: (1) NCLT and foreign court, and (2) NCLT and foreign representative	-
	Only IA exist, no IL	Of foreign proceeding by NCLT (as main or non-main)	For foreign representative to India	Between: (1) NCLT and foreign court, and (2) NCLT and foreign representative	-
	Only IL exist, no IA	-	For Indian creditors to the foreign proceeding	-	-
Concurrent proceedings (Indian + Domestic or Foreign)	IA and/or IL exist	(1) Of Indian proceeding in domestic/ foreign jurisdiction, and (2) Of domestic/ foreign proceeding in India (decision on which is main)	(1) For Indian IP to foreign jurisdiction, (2) For foreign representative to India, and (3) For Indian creditors to the domestic/ foreign proceeding	Between: (1) NCLT and foreign court, (2) foreign court and Indian IP, (3) NCLT and foreign representative, and (4) Indian IP and foreign representative	Between Indian and domestic/ foreign proceeding

[1]*IA: Indian Assets; IL: Indian Liabilities*

Source: CBIRC Report, June, 2020

For each of the above, the Committee recommends that procedural requirements are required to be laid down for the modalities of initiating each of the actions, the ongoing process and termination of the actions.

Even as cross-border transactions, assets and liabilities are increasingly being dealt with by the NCLT here in India on the basis of its own wisdom, when the recommendations of ILC and CBIRC are operationalized in the form of amendments to the Act, Rules and Regulations, and notified, it is believed that it will be a boost to cross-border transactions and enhance the image of the country as one capable of meeting the requirements of international participants to the fullest extent.

GROUP INSOLVENCY

As indicated in the introductory paragraphs, the Working Group on Group Insolvency submitted its Report on September 23, 2019 to recommend a framework for facilitation of insolvency resolution and liquidation of group companies. However, MLEGI which was adopted on July 15, 2019 was not considered by the Working Group. The CBIRC was given the task of considering MLEGI and making recommendations on its adoption and the recommendations of CBIRC-II Report on Group Insolvency were submitted on December 10, 2021. An overview of the recommendations made by CBIRC-II is as under:

a) **Scope of group insolvency:** The Committee recommended a framework that is voluntary and flexible and which shall be implemented in phases, with the first phase involving only domestic group insolvency.

b) **Adoption of MLEGI:** The Committee advised postponement of adoption of MLEGI after enactment of single-entity cross-border insolvency provisions in Part Z of IBC.

c) **Substantive consolidation:** In respect of pooling of assets and liabilities of a group under insolvency, the Committee did not recommend its inclusion in IBC as of now and recommended that they be inserted at a later stage after evolution of jurisprudence in this regard, and the current practice of dealing with this through case laws in exceptional circumstances may be undisturbed as of now.

d) **Definition of Group:** The Committee recommended that the term group may be defined to include companies and limited liability partnerships on the basis of control and significant ownership. Further, the provisions shall be made applicable only to insolvent entities in the group and not to the solvent entities. It is hoped here that sufficient safeguards are put in place to prevent abuse of such distinction.

e) **Procedures:** Procedural mechanisms should be provided under the framework including permitting of filing joint applications for initiation of CIRP in respect of multiple entities before the AA.

f) **Consolidation of proceedings:** All insolvency proceedings in respect of members of the same group shall be filed with the same AA and in case of subsequent proceedings to be initiated, they shall be filed with the same Authority with whom the first of such proceedings was filed. A common IP may also be appointed. An additional time period of 90 days may be added to the existing time frame for the insolvency resolution of the participating group members. The costs of group coordination proceedings shall form part of the insolvency resolution or liquidation process costs of the participating group members.

g) **Group committee of creditors (CoC):** A group CoC may be formed at the discretion of the CoCs for providing procedural assistance while retaining the decision-making powers with the respective CoCs of the group entities. Participation in the group coordination proceeding shall be voluntary and the CoCs may have the flexibility to opt-in till 30 days of initiation. Joining in after that will be subject to approval of participating CoCs and Liquidators, and the participating group members may be able to opt out till a group strategy is approved by the respective CoC. The group CoC shall have sufficient representation from the CoCs of the participating group members. The separate CoCs can delegate the functions to the group CoC except the power to approve a resolution plan.

h) **Group Strategy:** The main purpose of the group proceeding is to arrive at a group strategy by the group coordinator, which may provide for different measures for different participating members. This shall require approval of the participating CoCs by 66% of each of their voting shares respectively. On approval the group strategy shall be filed with the AA and on approval by the Authority be binding on all the parties.

i) **Termination:** The group coordination proceeding shall terminate once the group strategy is approved and implemented, or when the participating liquidators and CoCs have approved the termination by requisite majority, or when they have failed to approve a group strategy and when the group coordinator is of the opinion that arriving at such a group strategy is not feasible.

j) The Committee also recommends that the provisions already present in IBC to deal with avoidance and fraudulent transactions shall suffice for now and further safeguards, if necessary, shall be inserted at a later stage based on experience.

CONCLUDING THOUGHTS

As the world increasingly becomes a global village and as operations of an entity are spread across geographies either directly or indirectly through group structures, and even as the risks faced by the businesses are ever increasing, suitable frameworks for resolving insolvency on a global scale and on a group-level have become an urgent necessity. The various Committees set up by the Central Government have delved into the matters deeply and have come up with proposals for adoption of internationally accepted best practices in a manner that would best serve the interests of all stakeholders as well as considering the stage of economic development of the country. Once accepted and operationalized, the framework providing for access, recognition, cooperation and coordination in respect of foreign proceedings is expected to bolster the confidence of foreign investors, foreign lenders and supplier in India as an investment destination and marketplace.

[1] UNCITRAL Legislative Guide on Insolvency Law.

[2] UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment (2019).

[3] Regulation (EU) 2015/848 of the European Parliament and of the Council.

[4] Report of Insolvency Law Committee on Cross-Border Insolvency, October, 2018

[5] Report of the Working Group on Group Insolvency, January, 2019.

[6] Report on the rules and regulations for cross-border insolvency resolution, June, 2020.

[7] Report of CBIRC-II on Group Insolvency, December, 2021.

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Thinking Beyond Borders: Cross-Border Insolvency in IBC 2.0

- Laura N. Coordes

INTRODUCTION

In the relatively short time since its enactment, India's Insolvency and Bankruptcy Code, 2016 (IBC/Code) has done significant work to modernize and streamline Indian insolvency proceedings. At the same time, the need for reform has also become apparent, and India is already considering the next version of the IBC (IBC 2.0).

This contribution posits that India should incorporate a cross-border insolvency framework based on the Model Law on Cross-Border Insolvency (Model Law) into the IBC 2.0. However, merely incorporating this framework, without more, will not achieve the goal of attaining efficiency in cross-border transactions. Indeed, India should consider what additional steps should be taken in conjunction with adoption of the Model Law. Although the Model Law's success or failure on a global scale is outside India's control, to ensure maximum effectiveness of the Model Law's framework, India should take a holistic approach to examining cross-border insolvency needs. This essay outlines a few points India should consider if it wishes to adopt a cross-border framework based on the Model Law.

THE NEED FOR CROSS-BORDER INSOLVENCY PROCEEDINGS

In 1997, the United Nations Commission on International Trade Law (UNCITRAL) created the Model Law to *'assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency.'*[1] The Model Law does not seek to unify the substantive law of enacting States; instead, it authorizes and encourages coordination and cooperation among enacting States while recognizing that there may be differences in those States' insolvency laws.[2]

With the growth of international commerce comes a growing need for cross-border coordination and cooperation in a multitude of areas, including insolvency law.[3] UNCITRAL believes that States need a framework to be able to effectively address cross-border insolvency issues, and the Model Law is its response to this perceived need.[4]

Four principles undergird the Model Law: (a) access, (b) recognition, (c) relief, and (d) cooperation and coordination.[5]

First, the Model Law provides direct access to domestic courts for both foreign representatives and creditors involved in insolvency proceedings.[6] Representatives of local proceedings being held in the enacting State may seek assistance from foreign courts.[7]

Second, the Model Law provides a recognition process—a way for domestic courts to recognize foreign proceedings.[8] The Model Law accomplishes this through a series of 'simplified procedures' that efficiently provide certainty with respect to a court's decision to recognize a foreign proceeding.[9] Under the Model Law's framework, domestic courts may recognize a foreign proceeding as either a foreign main proceeding or a foreign non-main proceeding, depending on the location of the debtor's center of main interests (COMI).[10] Once the foreign proceeding is recognized, the court may provide relief to assist the foreign proceeding as outlined below.[11]

To ensure that cross-border insolvencies are conducted efficiently and fairly, the Model Law specifies various forms of available relief.[12] A non-exhaustive list of available relief includes interim relief, available at the court's discretion between the time an application for recognition is made and the time a decision on that application is made; the imposition of an automatic stay upon recognition of a foreign main proceeding; and post-recognition relief for both foreign main and foreign non-main proceedings, at the court's discretion.[13]

Finally, the Model Law encourages cooperation between Insolvency Professionals (IPs) and courts and assists countries in coordinating their insolvency laws through the provision of a 'modern, harmonized and fair framework.'[14] The Model Law specifically encourages cooperation among the courts of States where the debtor's assets are located, as well as coordination of concurrent proceedings involving the same debtor.[15] The Model Law empowers courts to cooperate and communicate with their foreign counterparts.[16] The Model Law also authorizes cooperation between courts and foreign representatives, as well as between foreign and local representatives.[17] The Model Law's provisions addressing coordination of concurrent proceedings also aim to generate decisions that would achieve the objectives of both proceedings.[18]

In short, UNCITRAL recognized a need for a procedural cross-border insolvency framework many years ago, and the Model Law is designed to fulfill that need.

ADOPTION OF THE MODEL LAW

Despite the attributes described above, many States have been hesitant to adopt the Model Law. To date, 50 States in 54 jurisdictions have adopted the law, but many significant global economies-including most EU nations, and several major Asian nations, including China, India, and Hong Kong-have not yet adopted it.[19] The Model Law is designed to work on a large scale, so it will be more effective if more States adopt it.[20]

THE MODEL LAW'S STRENGTHS AND WEAKNESSES

Adoption of the Model Law provides several distinct advantages to the adopting State. Notably, the Model Law provides foreign representatives with a way to recover assets outside of their domestic courts.[21] Cross-border issues may be resolved more efficiently under the Model Law's framework, particularly given that the law facilitates direct access to courts in enacting States.[22] The Model Law also provides flexibility with respect to how States incorporate it into their existing domestic law.[23] Although this flexibility may encourage more States to adopt the Model Law, it may ultimately weaken the law's effectiveness, as discussed further below.

The Model Law's most salient benefit for India is likely to be the robust framework it provides for cross-border insolvency.[24] At least one court in India has already proclaimed the lack of such a framework to be problematic.[25] Thus, the Model Law could fill an important gap in India's current domestic legislation.

However, it is important to recognize that the Model Law is not a panacea. As discussed below, many enacting States have weakened the law's effectiveness through the introduction of reciprocity requirements and other variations.[26] In addition, although the Model Law can undoubtedly facilitate the recovery of assets overseas, it cannot, by itself, track assets or disentangle complex corporate structures.[27]

As mentioned above, the Model Law allows flexibility for enacting States to include various concessions or accommodations.[28] For example, enacting States may exclude certain entities from the Model Law's operation.[29] An enacting State may also honor treaties or other obligations over the Model Law should a conflict arise.[30] The Model Law also provides a public policy exception, allowing domestic courts to refuse actions under the Model Law that would be 'manifestly contrary' to the enacting State's public policy.[31]

These concessions are designed to make States feel more comfortable incorporating the Model Law into their domestic legislation; however, this relative freedom has also enabled enacting States to adopt the Model Law with 'significant changes', some of which may be inconsistent with the law's objectives.[32] For example, countries such as South Africa, Mexico, and the British Virgin Islands have included a reciprocity requirement, refusing to apply the Model Law unless the foreign State(s) in question has also adopted it.[33] States have also excluded a variety of different entities from the Model Law's application, including banks, financial institutions, insurance companies, and credit institutions.[34] Several countries, including Mexico, Poland, and the British Virgin Islands, have also enacted broader public policy exceptions than what is articulated in the Model Law.[35] Still others have restricted the foreign representative's right of access to their courts.[36] Other States have deviated from the Model Law with respect to recognition, the granting of interim relief, coordination, and priority of foreign creditors' claims.[37] Enacting States may feel that these variations are necessary; however, increased variation risks undermining the Model Law's core foundations and making the law less useful.

Even if a State enacts the Model Law with no variations, it still needs the infrastructure—in terms of court systems and IPs—to competently and efficiently address issues arising under the law.[38] Notably, conflicts of laws issues may arise with respect to any number of issues, including recognition and enforcement of foreign court decisions, recognition of foreign creditors' claims, and differences in asset distribution laws.[39] Put simply, States still need their domestic laws and domestic courts to work well if the Model Law is to function as intended.

The Model Law's shortcomings have led some to label it a 'limited success'.[40] At bottom, the Model Law is less a 'law' in the traditional sense and more a recommendation.[41] Although UNCITRAL has encouraged States not to modify the Model Law, States have not hesitated to deviate from it whenever they feel it necessary.[42] Consequently, many States have adapted the law to function in the enacting State's own national interest rather than with an eye toward cross-border harmony.[43] This can be seen in the reciprocity requirement some States impose, out of fear that their creditors will receive diminished treatment in foreign jurisdictions if reciprocity is not imposed.[44]

States have varying perceptions of cross-border insolvency, and for some, the Model Law may be a solution in search of a problem.[45] The Model Law is not the only mechanism available for addressing cross-border issues. Other mechanisms are available, including domestic statutes; international treaties and conventions (usually at the regional level); local and regional rules, regulations, principles, and guidelines; and protocols—laws tailor-made to address issues and procedures in individual cases.[46]

As evidence that protocols work effectively even in the Model Law's absence, scholars have pointed out that several large cross-border cases have successfully utilized protocols.[47] The case of *Lehman Brothers* is particularly salient. With operations in over 40 countries, Lehman commenced 75 bankruptcy cases across 9 countries, six of which had not adopted the Model Law.[48] Lehman was thus largely resolved using a cross-border insolvency protocol tailored to the needs of the case. If acceptable procedures can be arranged via *ad hoc* protocols tailored to specific needs, the Model Law may be less useful than expected.

Nevertheless, proponents of the Model Law's widespread adoption have observed that the Model Law is very effective in centralizing insolvency proceedings and in avoiding the *Lehman*-esque scenario of multiple proceedings operating in different jurisdictions.[49] Centralized proceedings can lower costs and minimize the risk of judgments that are inconsistent or conflicting.[50] These benefits, in turn, enhance the prospect of a successful reorganization, thereby increasing creditor returns and supporting financial stability and growth.[51] Through its framework, the Model Law has arguably incentivized creditors to invest in cross-border entities, as they can be more confident in their rights upon default.[52] Proponents of the Model Law also point out that, compared to alternatives, the Model Law provides 'consistent and predictable outcomes'.[53] If and when the Model Law is adopted on a larger scale, this predictability and consistency has the potential to be global, rather than merely regional, in scope.[54]

Furthermore, the fact that other treaties, frameworks, and protocols exist does not mean that they must be supplanted by the Model Law. Rather, they can be pursued in tandem with the Model Law.[55] Put differently, the Model Law can complement the work of other mechanisms for cross-border coordination.

THE MODEL LAW'S ADOPTION IN INDIA

India has been thinking about adopting the Model Law for some time. In 2018,[56] the Insolvency Law Committee (ILC) suggested that India adopt a framework such as the Model Law in response to concerns about an inadequate cross-border insolvency framework in India.[57] Specifically, the ILC believed that India's current legal framework for cross-border insolvency, consisting of sections 234 and 235 of the IBC, is not sufficiently comprehensive to address today's cross-border issues.[58] The Ministry of Corporate Affairs formed a Cross Border Insolvency Rules/ Regulations Committee (CBIRC) to further consider these issues in 2020.[59]

India has also released a set of draft guidelines, titled Part Z, regarding cross-border insolvency.[60] Based on the Model Law, these guidelines are intended to apply only to corporate debtors and only to countries that have adopted the Model Law.[61] The guidelines provide for a method of determining a debtor's COMI, as well as provision for foreign main and foreign non-main proceedings.[62]

In short, India seems poised to adopt some version of the Model Law, and if the IBC is significantly revised, it is an opportune time to discuss incorporation of the Model Law into an IBC 2.0.

OTHER CHANGES NEEDED

However, in order for India to successfully incorporate the Model Law (or any other more formalized cross-border framework), other changes will be needed. Of course, as with any cross-border issue, the effectiveness of the Model Law is not dependent on the actions of any one State by itself. However, there are a few changes India can consider making in connection with adoption of the Model Law.

Improved efficiency

Delays in any insolvency proceeding can negatively affect the parties, especially creditors.[63] There are currently significant delays in moving insolvency cases through the Indian insolvency process. Delays in court could negatively impact the effectiveness of a cross-border law if overseas courts move more quickly than Indian courts in admitting and resolving cases.[64] Consequently, India should take steps to ensure greater efficiency and speed in moving all types of cases—domestic and cross-border—through its courts.

Reciprocity

Reciprocity, or the requirement that Model Law proceedings will only apply if the foreign jurisdiction has also adopted the Model Law, presents another barrier to the Model Law's effectiveness.[65] If India enacts the Model Law without a reciprocity requirement, it could facilitate wider use of the Model Law in India.[66] The success of any cross-border proceeding depends on trust and good working relationships between domestic and foreign courts. While this trust may take time to develop, it is worth considering whether to adopt the Model Law without a reciprocity requirement in order to facilitate its use.

Corporate groups

By its terms, the Model Law applies only to a single company, although in practice, corporate groups have filed jointly under the Model Law.[67] To increase the Model Law's effectiveness, consideration should be given to its application to corporate groups. This is because corporate group arrangements today are increasing in complexity, and parent and subsidiary entities may often be found in different jurisdictions.[68]

In response to this trend, in July of 2019, UNCITRAL approved the Model Law on Enterprise Group Insolvency (MLEGI). This law is designed to facilitate corporate group insolvency proceedings through the use of planning proceedings and the appointment of a group representative to develop a group insolvency solution for members of a corporate group.[69] Like the Model Law, the MLEGI has provisions for mutual recognition of its proceedings and for court cooperation to implement solutions devised by the group representative.[70]

Like the Model Law, the MLEGI will be more effective for corporate group insolvency if its adoption is widespread.[71] Thus, India should consider whether it should adopt the MLEGI, or some appropriate means of facilitating corporate group insolvency, along with the Model Law.

Recognition of foreign judgments

By itself, the Model Law cannot provide certainty when it comes to enforcing foreign judgments. Thus, 'a common, predictable framework' for recognition and enforcement of judgments is needed.[72] Otherwise, secured creditors could derail otherwise court-approved restructuring plans if they attempt to enforce their rights over assets located in a foreign jurisdiction.[73] This is not merely a theoretical concern, as, for example, English courts apply the *Gibbs* rule, which allows creditors whose debts are governed by English law to 'avoid the consequences of a debt discharge by a foreign restructuring plan'.[74]

In response to these challenges, UNCITRAL has developed a Model Law on the Recognition and Enforcement of Insolvency-Related Judgments (MLIJ). Consequently, India should consider whether to adopt this law along with the Model Law and the MLEGI.

Protocols

As mentioned above, protocols are case-specific procedures that describe the exact means of cooperation between courts and insolvency practitioners.[75] These protocols need not be jettisoned merely because a State has adopted the Model Law. Thus, even if India adopts the Model Law, it should also consider further adoption of specific court-to-court cooperation protocols as and when needed.[76] These protocols could address specific matters such as the process for joint hearings, procedures for sharing information, and preferred communication methods for each cross-border case.[77]

As protocols are case-specific, the adoption of numerous protocols can seem daunting. Yet, protocols need not be created from scratch. Rather, prior cases can provide guidance as to best practices. Successful examples of prior cases using protocols include the *Halifax* case, which concerned a joint sitting between the Federal Court of Australia and the High Court of New Zealand, and the *Nortel Networks* case, where coordination and cooperation protocols, as well as joint hearings between courts in the United States and Canada, were put into place.[78] Thus, India should still consider the development of case-specific protocols even if it enacts the Model Law.

Mediation and alternative dispute resolution

Mediation, and potentially other forms of alternative dispute resolution, can be used in domestic and cross-border cases alike to facilitate agreement among the parties.[79] As India is already considering ways to incorporate mediation into its domestic insolvency proceedings, it should also consider ways to utilize mediation in cross-border proceedings.

Conflicts of law

Finally, and as noted above, the Model Law does not seek to harmonize substantive insolvency laws, and conflict of laws issues are currently present in cross-border cases.[80] An UNCITRAL working group is developing draft legislative provisions seeking to provide more clarity on the determination of what law applies to which aspects of a cross-border insolvency proceeding.[81] Thus, India should monitor the development of these provisions and should consider adopting them in connection with its cross-border proceedings.[82]

CONCLUSION

India should absolutely consider the adoption of the Model Law in the next version of its IBC. However, the Model Law alone is not a holistic solution to the problems of cross-border insolvencies. Instead, India should view the Model Law as one 'brick' in the wall of cross-border structures and frameworks. The Model Law will work best in conjunction with other 'bricks', such as the MLEGI, the MLIJ, and specific protocols. In addition, India should consider ways to speed up its domestic insolvency processes, along with ways to incorporate mediation and alternative dispute resolution procedures into both domestic and cross-border cases. In short, the Model Law's effectiveness in India, as well as elsewhere, is at least partially dependent on whether India adopts other measures to effectively respond to cross-border issues and needs.

[1] UNCITRAL Model Law on Cross-Border Insolvency (1997).

[2] *Ibid.*

[3] *Ibid.*

[4] *Ibid.*

[5] Lalwani R. and Tiwari A. (2022), "An Overview of Cross-Border Insolvency in India", Lexology, March 18; Supra Note 1.

[6] Supra Note 5; Supra Note 1.

[7] Supra Note 1.

[8] Supra Note 5.

[9] Supra Note 1.

[10] *Ibid.*

[11] *Ibid.*

[12] *Ibid.*

[13] *Ibid.*

[14] Supra Note 5.

[15] Supra Note 1.

[16] *Ibid.*

[17] *Ibid.*

[18] *Ibid.*

[19] Atkins S. and Martin J. (2022), "The Model Law on Cross-Border Insolvency: A Silver Lining, But Not a Silver Bullet", Norton Rose Fulbright.

[20] *Ibid.* ("Indeed, international regulatory and policy frameworks are only ever as effective as their local implementation.").

[21] Chavan I. (2022), "Explained: Cross Border Insolvency Law, and Why Amendments in IBC Are Necessary", *Economic Times,* Feb 14.

[22] *Ibid.*

23 Mohan S. (2012), "Cross-Border Insolvency Problems: Is the UNCITRAL Model Law the Answer?", 21 Int'l Insol. Rev. 199, 5.

[24] Supra Note 5.

[25] Supra Note 21 (citing the National Company Law Tribunal in Mumbai in the Jet Airways case).

[26] Supra Note 5.

[27] Supra Note 21 .
[28] Supra Note 23, p. 6.
[29] Article 1 (2), Model Law.
[30] Article 3, Model Law.
[31] Article 6, Model Law.
[32] Supra Note 23, p. 11.
[33] *Ibid.*, p. 12.
[34] *Ibid.*, p.14.
[35] *Ibid.*, p. 15.
[36] *Ibid.*, p. 16.
[37] *Ibid.*, pp. 18-19.
[38] *Ibid.*, p. 2.
[39] *Ibid.*
[40] *Ibid.* at 9 (observing that “it may not be possible to regard the Model Law on Cross-Border Insolvency as a success”).
[41] *Ibid.*, p. 18.
[42] *Ibid.*, p. 19.
[43] *Ibid.*, p. 20.
[44] *Ibid.*
[45] *Ibid.*, p. 21.
[46] *Ibid.*, pp. 22-27.
[47] *Ibid.*, p. 26 (citing protocols used in *Matlack*, Lehman Brothers, Bernard Madoff, and Nortel Networks).
[48] *Ibid.*, pp. 26-27.
[49] Supra Note 20.
[50] *Ibid.*
[51] *Ibid.*
[52] *Ibid.*
[53] *Ibid.* (comparing the Model Law to common law comity, civil law exequatur, and regional frameworks such as the European Insolvency Regulation recast).
[54] *Ibid.*
[55] *Ibid.*
[56] Supra Note 21.
[57] Supra Note 5.
[58] *Ibid.*
[59] Vora R. (2022), “Discussions are on to Bring Cross-Border Insolvency Under IBC”, *The Hindu Business Line*, April 30.
[60] Supra Note 5.
[61] *Ibid.*
[62] *Ibid.*
[63] Mehta D. (2022), “View: Delay in Implementing Cross-Border Insolvency Law is Detrimental to Indian Creditors”, *The Economic Times*, September 6.
[64] *Ibid.*
[65] Supra Note 23, p. 12.
[66] Supra Note 3.
[67] *Ibid.*
[68] Supra Note 20.

[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72] *Ibid.*
[73] *Ibid.*
[74] *Ibid.*
[75] *Ibid.*
[76] *Ibid.*
[77] *Ibid.*
[78] *Ibid.*
[79] *Ibid.*
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*

24

An Effective Approach Towards Cross - Border Transaction Avoidance: Comparative Perspectives

- Rebecca Parry and Risham Garg

INTRODUCTION

Transaction avoidance provisions play an important role in insolvency proceedings, both in terms of protecting the value of the insolvency estate and in maintaining and enforcing the creditor waterfall in liquidation.[1] In the months prior to the commencement of an insolvency, it is common for debtors, for example, to attempt to conceal assets from creditors, sell assets to associates at low prices, or to pay off favoured creditors in order that they don't have to present a claim in the insolvency. Avoidance laws enable such transactions to be neutralised and value recovered to augment the sums available for distribution to creditors. Although potentially voidable transactions are common and similar types of avoidance laws to those found in India appear in the insolvency laws of most jurisdictions, there are differences in the content of these laws. In addition, the transfer of assets outside of India can present difficulties for enforcement of claims. This is an area of cross-border insolvency which can present difficulties, and these are only partially addressed by instruments such as the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI).[2] This article will outline transaction avoidance laws, comparing those found in India with those in selected other jurisdictions. It will then consider the cross-border insolvency aspects, including the impact that the MLCBI and the new Model Law on Insolvency-Related Judgments (MLIJ) would have, if adopted.

OVERVIEW OF TRANSACTION AVOIDANCE

Transaction avoidance provisions enable office holders to examine a debtor's prior transactions to identify those that are detrimental to creditors and to brings proceedings on various grounds to recover property for the benefit of creditors. Although there are similar types of transaction avoidance in many countries, there are differences in how these laws are drafted, particularly so in the case of preferences, voidable payments made before the start of the insolvency. Different objective and subjective criteria, variations in suspect periods, different exceptions and approaches to connected parties are only some of the ways in which there can be differences that mean that a transaction that is voidable under one country's laws would escape avoidance under another country's laws. Cross-border cases bring further complication of not only identifying the correct insolvency laws to apply but also relevant non-insolvency laws, since the latter provide the context for the transaction, determining matters such as whether the transaction was carried out with a valid contract.[3] An overview of the avoidance laws in some jurisdictions will follow but first the laws of India will be discussed in order that comparisons may be made.

OVERVIEW OF INDIAN LAWS

Transactions that may be avoided during insolvency proceedings in India are classified under five types under the Insolvency and Bankruptcy Code, 2016 (IBC/Code); (a) Preferential,[4] where the anterior period is 12 months, and two years if preference was given to a related party[5] (b) Undervalued,[6] the anterior period is 12 months, and two years if the transaction was with a related party (c) Extortionate,[7] where the look-back period is two years (d) Transactions defrauding creditors, (e) Wrongful (or fraudulent) trading.[8]

An application for an avoidable transaction should be filed within the prescribed relevant time or look back period, which is usually one year in most cases and two years in case of a related party. A transaction will not qualify as preferential if - (a) it is made in ordinary course of business and (b) if it creates new value for the corporate debtor (CD). In the case of Jaypee Infratech,[9] the CD had mortgaged its property as collateral security for the debt of its holding company. It was held to be a preferential transaction entered into for the benefit of a related party. Where the interest rate was 65% per annum and found to be well-above the business standards as prevailing in the market, it amounted to an extortionate transaction.[10]

Fraudulent trading or wrongful trading, intent to defraud

The IBC under section 66 confers wide powers on the Adjudicating Authority (AA) to pass appropriate orders and to do justice where, during the pendency of corporate insolvency resolution process (CIRP) or liquidation process it suspects that the business of the CD was being carried on '*with the intent to defraud creditors of the corporate debtor or for any fraudulent purpose*' by the directors/partners or any other persons related to the CD.

Where the director ought to have known that there was no reasonable prospect of (a) avoiding the insolvency, (b) did not exercise due diligence in minimizing the loss, (c) were involved in fraudulent business, the said directors or officials can be required to personally contribute to the assets of the CD. Additionally, such persons shall also be liable for imprisonment for up to five years and fine of up to ₹1 crore.[11]

Where the CD had entered into undervalued transactions with the sole intent to keep its assets beyond the reach of its creditors during the CIRP,[12] the said transactions were declared null and void.[13]

At times, the management takes certain decisions which may not work out as intended and eventually result into hefty monetary losses. It was held that such bad commercial business decisions cannot be considered to be fraudulent or wrongful trading.[14] Write-offs are an internal accounting procedure which is necessarily to be followed by any corporate entity, these do not always demonstrate any fraudulent intention. Money received from life insurance was diverted towards salaries, bonus, gratuity payment to employees/workmen; amount was not concealed, held does not amount to wrongful trading.[15]

Continuing the transaction avoidance proceedings

It is not always possible for the AA to dispose of avoidance transaction applications during the tenure of CIRP or liquidation process. Hence, it is now mandatory to include in the resolution plan, the manner in which such applications will be pursued after the approval of the resolution plan.

BRIEF COMPARISONS WITH UK, US, CHINA, PROPOSED EU HARMONISED LAWS

In this section some brief comparisons are made in relation to three of the common types of avoidance action found in India, namely undervalue transactions, preferences and transactions defrauding creditors. Since extortionate credit transactions are not always subject to a specific avoidance provision, they will not be discussed in detail. In the interests of brevity this is also a generalised discussion to bring out key points of difference. This section will also focus on suspect transactions and will not deal with director liabilities.

UK

This section will primarily discuss the avoidance laws of England and Wales, which has a similar range of avoidance laws (although not always similar in substance) to those which apply in India, with some brief mentions of the law in Scotland. Transactions at undervalue,[16] preferences,[17] extortionate credit transactions[18] and transactions defrauding creditors[19] are all included in the Insolvency Act, 1986.

Transactions at undervalue are voidable if the consideration received by the debtor was of a value significantly less than the value given,[20] provided that the transaction was entered into in the two year look back period and at a time when the company was insolvent.[21] There is a defence, however, for transactions entered into in good faith for the purpose of carrying on business with reasonable grounds to believe that the transaction would benefit the company.[22] It will be noted that by including subjective criteria the defence is potentially narrower than the Indian exception for transactions in the ordinary course of business.[23] The preference laws of the 1986 Act are different from their Indian equivalent in that they apply only where the debtor was influenced by a desire to improve the position that the other party to the preference would have been in the event of the debtor's insolvent liquidation. Under the laws that apply in England and Wales influence is presumed in the case of a connected party but in other instances will be difficult to establish as often there will be a good reason why a creditor was paid, for example paying key creditors in order to keep trading.[24] In requiring influence by a desire to benefit the person receiving the preference, these laws differ from the laws of India, as noted, as well as those of the USA, for example, as will be discussed *infra*. It should be added that the law in Scotland is different from that of England and Wales and also follows a similar approach to India as regards unfair preferences.[25] It also has the law of gratuitous alienations, which is the Scottish equivalent of India's undervalued transactions.[26]

England and Wales also has a provision enabling the avoidance of transactions defrauding creditors.[27] As in India such transactions are only voidable if they are gifts or are entered into for a consideration which is significantly less than the value of the consideration provided, as well as being entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing creditors.[28] Arguably the fraudulent purpose of such a transactions should alone suffice as a basis for avoidance and the additional requirement that the transaction was entered into at an undervalue does not appear in the laws of many other countries and creates an unnecessary evidential difficulty in the way of avoidance.[29]

USA

Under US law, transfers are voidable under US Bankruptcy Code – section 547 as preferences and under section 548 if made with actual intent to hinder, delay, or defraud or for less than reasonably equivalent value. Therefore, the three main types of avoidance action are included. As in India, the main focus of a preference is on the preferential effect of the transaction.[30] Preferential transactions under section 547 must have taken place within 90 days of the date of the filing of the petition to open insolvency proceedings, extended to one year before in the case of a connected party. Since the scope of avoidance is potentially very wide there are, however, various defences that narrow its scope considerably in order that contractual certainty is not unduly undermined.[31] These defences include the defence for transactions in the ordinary course of business or on ordinary business terms.[32] Section 548 has a look back period of two years and a requirement that the debtor was insolvent at the time.

China

The three main types of avoidance action discussed in this section are all present in China's laws. Article 31 of China's Enterprise Bankruptcy Law enables the avoidance of various types of undervalued transaction which took place in the one year prior to the commencement of the insolvency case, namely (a) transfers of assets free of charge; (b) transactions in respect of which the company received an unreasonably low price; (c) the provision of property security in respect of an unsecured debt; (d) the repayment of a debt that has not fallen due; (e) the giving up of a claim as a creditor. The payment of a debt that has not fallen due may be regarded as an unfair preference of a creditor, since such a creditor would otherwise only be able to claim as an unsecured creditor in the bankruptcy. However there is a separate preference provision in Article 32, which provides that if the debtor, at a time when the debtor was insolvent, repaid a debt to an individual creditor within a look back period of six months leading up to the court's acceptance of the insolvency case, the Administrator is entitled to apply to the court for an order under which the repayment can be rescinded, unless the repayment was beneficial for the debtor's property. The exception that the payment was beneficial for the debtor's property is a potentially broad defence that would enable account to be taken, for example, of a payment made to a creditor, without which the creditor would have refused to continue to supply the company with goods or services necessary to the company's survival. Article 33 relates to dishonest transactions, either involving hiding or transferring property in order to evade the claims of creditors; or fabricating debts or admitting fabricated debts.

European Union

Transaction avoidance laws are presently a matter for each EU member state to enact under its own domestic laws. There are great differences in the content of these laws and potential for avoidance and the presently-unsatisfactory choice of law approach that is adopted is discussed in the next section. The EU is proposing to introduce minimum levels of harmonisation of avoidance laws.[33] These laws are based on a study of existing avoidance laws in the member states which ultimately recommended an approach based on a 'blank slate', rather than an adaptation of any member state's existing laws.[34] The proposed laws largely use objective criteria. Undervalue transactions would be voidable if entered into within one year of the filing for insolvency proceedings if for no consideration, or for manifestly inadequate consideration. The preference laws would apply to transactions within three months of the filing and, if the payment was in respect of a debt which was due, it is also required that the debtor knew or should have known at the time of the transaction that the debtor was unable to pay its debts or that insolvency proceedings had been filed for. Fraudulent transactions would be voidable where the debtor intentionally caused detriment to its general body of creditors and where the relevant act took place four years prior to the insolvency filing and the other party knew of the debtor's intention. Since the harmonisation proposal is for a directive the member states will be given a timetable to transpose these laws but these are minimum standards and the member states retain flexibility to have additional avoidance laws.

Observations

There are notable differences in relation to avoidance laws in different countries and those above provide merely a snapshot of the systems in some notable jurisdictions. Ultimately an approach of harmonisation can work to eliminate some of the difficulties of cross-border transaction avoidance cases, but it requires considerable will and collective endeavour to implement such an approach. The differences in laws therefore can be potentially exploited by defendants in transferring assets to jurisdictions with narrow avoidance laws and such transfers can also compound the practical difficulties of pursuing avoidance transactions across borders, as the next section will illustrate. Differences in laws can also be exploited by office holders too, in forum shopping for the jurisdiction with the best chance of avoidance, as in the *Maxwell Communications* case, discussed below. As that case illustrates, there is a need for collaboration and cooperation among practitioners and courts in different jurisdictions and adoption of the MLCBI, and the more recent MLIJ can help in this regard.

APPROACH UNDER PRIVATE INTERNATIONAL LAW

Proceedings have been opened in Country A and there has been a transaction that is voidable under Country A's laws in favour of B who is resident in Country B. What are the prospects for the avoidance of the transaction? Primarily this question will depend on recognition of Country A's insolvency proceeding in Country B as well as Country B's approach to enforcement of foreign judgments and the complexities are too great to do justice to here. In recent years considerable progress in smoothing out difficulties has been made in cross-border insolvency cases through the use of protocols,[35] as proved valuable in the *Jet Airways* case.[36] Such contractual and cooperative approaches can potentially enable much progress to be made in determining the correct venue and laws for avoidance actions with one court deferring to another.

There is already a remarkable precedent for such an approach in the *Maxwell Communications* proceedings, a case which was part of the inspiration for the Model Law.[37] The avoidance proceedings in the case included an attempt at forum shopping. Maxwell Communications had entered administration in the UK and Chapter 11 in the US. Shortly before the orders that opened these proceedings the company had repaid to its bank the sum of $30 million, at the bank's request. This payment was challenged as a preference under section 547 of the US Bankruptcy Code, which offered favourable prospects for avoidance since, as noted above, the UK equivalent requires for the debtor to have been 'influenced by a desire' to improve the position of the other party in the debtor's insolvency. There were, however, stronger links with the UK as both Maxwell and the bank were UK companies. The bank had initially obtained an anti-suit injunction but this was not renewed as it was for the US court to determine whether the case had been properly brought. Later the judge in the US case, the late Tina Brozman, declared the UK to be the more appropriate forum.

EU case law and approach

A choice of law rule may apply in some instances to give clarity. An example appears in the EU Regulation on Insolvency Proceedings, originally enacted in 2000 and recast in 2016[38] in an approach that is a suboptimal compromise. The starting choice of law rule under the Regulation is that the applicable law in avoidance proceeding would be the law of the state where proceedings were opened.[39] There is however a defence where the act is subject to the law in a different member state and the law of that member state does not allow any means of challenging the transaction.[40] This effectively creates the loophole that the transaction must be voidable under the laws of both the state where the insolvency proceedings were opened and the law to which the transaction is subject. The advantage is however greater certainty for the parties to transactions and such an approach is therefore understandable in encouraging trade. More recently there has, as noted, been a proposed directive that would require a minimum set of harmonised conditions for avoidance in the member states and this should resolve some of the difficulties of cross-border transaction avoidance.[41]

UNCITRAL Model Laws

The MLCBI has provided a modified universalist[42] framework of effective mechanisms for dealing with cases of cross-border insolvency. The MLCBI has been adopted in a growing number of jurisdictions, *inter alia* enabling office holders to request access to courts in enacting states, a framework for recognition of foreign proceedings and granting relief, as well as processes for coordination and cooperation.[43] It has been adopted for example in the UK as the Cross-Border Insolvency Regulations, 2006 and in the US under Chapter 15 of the US Bankruptcy Code.

Given the wide scope for discretionary assistance to foreign proceedings that have been recognised under the MLCBI it had been hoped that this law would enable more effective enforcement of transaction avoidance actions. This could potentially have been done under Article 21 of the MLCBI, which applies to relief that may be granted upon recognition of a foreign proceeding, or perhaps Article 7, a broad provision enabling assistance to be given. The matter was considered by the UK Supreme Court in *Rubin v. Eurofinance SA*,[44] in a case concerning the recognition of foreign transaction avoidance orders, where the defendant had not submitted to the jurisdiction of the foreign court. It was held by a majority that there was nothing express or implied in the MLCBI that applied special rules to the recognition or enforcement of foreign judgments against third parties. The matter was therefore approached under the general common law principle that the court would not enforce an *in personam* order against someone who was not in the jurisdiction, or who did not submit to the jurisdiction.

Although the US courts had taken a more generous approach to the recognition of foreign transaction avoidance orders, the uncertainty that the *Rubin* case led to was partly what prompted the MLIJ, which has become available for adoption by states (alongside the Model Law on Enterprise Group Insolvency).[45] The MLIJ is intended to address some of the difficulties that have arisen in the handling of insolvency-related judgments due to the differences between jurisdictions. Insolvency-related judgments are those which are issued on or after the commencement of insolvency proceedings, that arise as a consequence of or are materially associated with the proceedings. It enables adopting states to provide clarity regarding the recognition and enforcement of foreign insolvency-related judgments, although it includes also some public policy safeguards.

The MLIJ will aid enforcement through a simple and harmonised procedure that would clarify the MLCBI by addressing insolvency-related judgments, whereas the MLCBI itself would apply to the order which opens the insolvency proceedings themselves. Adoption of both instruments would therefore provide a comprehensive approach to the recognition and enforcement of both insolvency proceedings and insolvency-related judgments, although the MLIJ is self-standing and would also seem to cover some of the ground of Article 21 of the MLCBI. Adoption of the MLIJ can include adding an Article X to the MLCBI to clarify that Article 21 of the MLCBI applies to insolvency-related judgments.

CONCLUSION

Presently there are notable differences in transaction avoidance proceedings around the world. These differences can be exploited by defendants in transferring assets to make the prospects for avoidance more difficult for office holders. As more states adopt the MLCBI and/or the MLIJ the prospects for cross-border transaction avoidance will improve, although there is a long way to go before a large number of states will have either adopted the MLIJ or clarified the scope of Article 21 of the MLCBI, to clarify the approach to recognition and enforcement of avoidance actions and other insolvency-related judgments. The prospects for Indian office holders in obtaining assistance in foreign jurisdictions where assets have been transferred in a voidable transaction will still largely depend on common law assistance in the meantime.

[1] Parry R. et al. (2018), "Transaction Avoidance in Insolvencies", 3rd edition, Oxford University Press, 2.24.

[2] UNCITRAL Model Law on Cross-Border Insolvency, 30th May 1997.

[3] Westbrook J. L. (2005), "Universalism and Choice of Law", 23 Penn State International Law Review.

[4] Section 43, IBC.

[5] Section 5(24) of IBC provides which entities and person are related parties to a corporate debtor while section 5(24A) discusses related party in connection to an individual; see *Phoenix Arc v. Spade Financial Services Ltd.,* AIR 2021 SC 77.

[6] Section 45, IBC; see *IDBI Bank v. Jaypee Infratech, 2018, CA No. 26/2018 in C.P. No. (IB)77/ALD/2017.*

[7] Section 49, IBC.

[8] Section 66, IBC.

[9] *Anuj Jain IRP for Jaypee Infratech Ltd v. Axis Bank* (2020) 8 SCC 401.

[10] *Shinhan Bank v. Sungil India Private Ltd.,* 2019, CA IB No.-492/ND/2018, CA No. 184 of 2018.

[11] Section 69, IBC.

[12] *Edelweiss Asset Reconstruction Company Ltd v. Net 4 India Ltd.,* 2021.

[13] Sections 66 and 67, IBC.

[14] *RTIL Limited v. Nitin Kasliwal,* 2021, M.A. 05/2019.

[15] *R. Ramela Rangasamy v. Kandrikar Shahid Mansoor*, 2022.

[16] Section 238, The Insolvency Act, 1986.

[17] Section 239, The Insolvency Act, 1986.

[18] Section 244, The Insolvency Act, 1986.

[19] Section 423, The Insolvency Act, 1986.

[20] Supra Note 16.

[21] Section 240(1), The Insolvency Act, 1986.

[22] Section 238(5), The Insolvency Act, 1986.

[23] Section 45, IBC.

[24] See e.g. *Re Lewis's of Leicester Ltd* [1995] BCC 514.

[25] Section 243, The Insolvency Act, 1986.

[26] Section 242, The Insolvency Act, 1986.

[27] Supra Note 19.

[28] *Ibid.*

[29] Bork R. (2021), "Sequana I: Struggling with section 423 of the Insolvency Act 1986", 31 International Insolvency Review, 8.

[30] Section 547(b)(5), Chapter 11 of US Bankruptcy Code.

[31] Section 547(c), Chapter 11 of US Bankruptcy Code.

[32] Section 547(c)(2), Chapter 11 of US Bankruptcy Code.

[33] Hallak I. (2023), "Harmonising certain aspects of insolvency law in the EU", European Parliamentary Research Service.

[34] For a comprehensive review of existing laws, as well as a proposed model see Bork R. and Veder M., "Harmonisation of Transactions Avoidance Laws", Intersentia, 2022.

[35] Kamalnath A. (2013), "Cross–border insolvency protocols: a success story", 2.2 International Journal of Legal Studies and Research, 172.

[36] Shaikh G. (2021), "The Jet Airways' Cross Border Insolvency Protocol: A Success Story", Singapore Global Restructuring Initiative Blog, 26th January.

[37] "From the Bench - Tina Brozman explains why cooperation and rehabilitation are key to better bankruptcies", A CFO Interview, 1st June, 2003.

[38] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20th May 2015 on insolvency proceedings.

[39] Article 7(m), EU Regulation on Insolvency Proceedings.

[40] Article 16, EU Regulation on Insolvency Proceedings.

[41] Proposal for a New Insolvency Directive Harmonising Certain Aspects of Substantive Law on Insolvency Proceedings, 7th December, 2022.

[42] Mevorach I. (2018), "The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps", OUP 2018, Ch 1.

[43] Supra Note 2.

[44] [2012] UKSC 46.

[45] Alongside the *Rubin* case another problem has been that the Hague Convention on Private International Law, which establishes best practice in relation to the recognition of judgments, does not apply to insolvency-related judgments.

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EVALUATING CROSS-BORDER INSOLVENCY MECHANISM IN INDIA

- Vartika Misra

INTRODUCTION

The need for an international insolvency mechanism has arisen time and again and has been recognised since 1990s, culminating into the UNCITRAL Model Law on Cross Border Insolvency, 1997 (Model Law) on May 30, 1997 by the United Nations Commission on International Trade Law (UNCITRAL).[1] This need had been recognised by the Bankruptcy Law Reform Committee (BLRC) in its Interim Report where it was stated that:

> …the BLRC realises the importance of developing an efficient system for addressing cross-border insolvencies in India. In this regard, some of the previous law reform committees have recommended that the UNCITRAL Model Law on Cross-Border Insolvency should be adopted in India. The UNCITRAL Model Law provides a legal framework to coordinate cross-border insolvency proceedings so as to protect the interests of all stakeholders. The Model Law achieves this object by first, mandating judicial cooperation, secondly, by conferring on a foreign insolvency administrator (or a similar representative) standing in local proceedings and finally, by ensuring equal treatment to foreign and local claims…[2]

Thus, the BLRC highlighted that after adoption of Insolvency and Bankruptcy Code, 2016 (IBC/Code) and effectiveness and strength of a domestic insolvency regime, it would be crucial to provide for a scheme providing for cross-border insolvency mechanism based on the Model Law.[3] Many nations were encouraged to adopt the Model Law by the International Monetary Fund to have a uniform system of cross-border dispute resolution and a system for international mutual cooperation and assistance, consequent to which, the Model Law has been adopted by 58 States across a total of 61 jurisdictions.[4] Thus, in order to provide for a uniform process, the Model Law provides for principles of recognition and cooperation with respect to foreign proceedings and mutual cooperation between courts in different jurisdictions and Administrators appointed therein. In India, a need was felt for incorporation of Draft Part Z in light of the Model Law, since provisions in the Code, namely section 234 and section 235 of the Code were not comprehensive enough. However, upon an examination of the Draft Part Z, certain issues come to the forefront which highlight the current problems associated with implementation of Draft Part Z. Thus, in order to suggest an overhaul of the insolvency mechanism in India, the focus and scope of this paper limits to identification of issues associated with the existing mechanism and a comparative analysis to suggest necessary reforms and tweaking of existing regime to accommodate imperative changes.

THE MODEL LAW AND EXISTING DOMESTIC REGIME

The Model Law addresses four pillars of cross-border insolvency which are (a) access, (b) recognition, (c) cooperation and (d) coordination, and provides a framework for international cooperation and a uniform and harmonised framework for addressing and resolving cross-border disputes. The BLRC considered the need of cross-border insolvency as an issue to be addressed in time. The BLRC, in its Report in November, 2015 noted that,

> The next frontier lies in addressing cross-border issues. This includes Indian financial firms having claims upon defaulting firms which are global, or global financial persons having claims upon Indian defaulting firms.
>
> Some important elements of internationalisation – foreign holders of corporate bonds issued in India, or borrowing abroad by an Indian firm – are dealt with by the present report. However, there are many other elements of cross-border insolvency which are not addressed by this report. Examples of these problems include thousands of Indian firms have become multinationals, and Indian financial investors that lend to overseas persons.
>
> The Committee proposes to take up this work in the next stage of its deliberations.[5]

It was also recommended by the Eradi Committee and by the N.L. Mitra Committee in 2001, for adoption of the Model Law by India to improve mutual assistance and coordination for cross-border dispute resolution, thereby increasing flow of foreign direct investments (FDI).[6] Following the recommendations of the Joint Committee on Insolvency and Bankruptcy Code, 2015, and in adherence with the said Joint Parliamentary Report, two provisions were added, namely, section 234 and section 235 of the Code.[7] Section 234 of the Code provides for conclusion of bilateral agreements with other nations for the purpose of cross-border insolvency resolutions and section 235 of the Code provides for issuance of letter of request by the National Company Law Tribunal (NCLT) to other courts of the country with which an agreement has been made. The said two provisions of the Code state as follows:

> Section 234 Agreements with foreign countries
>
> (1) The Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code.
>
> (2) The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified.
>
> Section 235 Letter of request to a country outside India in certain cases.
>
> (1) Notwithstanding anything contained in this Code or any law for the time being in force if, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, under this Code, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor

or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the Adjudicating Authority that evidence or action relating to such assets is required in connection with such process or proceeding.

(2) The Adjudicating Authority on receipt of an application under sub-section (1) and, on being satisfied that evidence or action relating to assets under sub-section (1) is required in connection with insolvency resolution process or liquidation or bankruptcy proceeding, may issue a letter of request to a court or an authority of such country competent to deal with such request.

The Insolvency Law Committee (ILC) released its first Report in March, 2018 wherein it observed the inadequacy of the two provisions, namely, section 234 and section 235 in providing a comprehensive framework in matters of cross-border insolvency and thereafter released its second Report on October 16, 2018, suggesting adoption of the Model Law with necessary modifications in the Code.[8] The ILC in its second Report proposed adoption of the Model Law, and for this purpose, proposed Draft Part Z to be incorporated in the Code to provide a mechanism for dealing with cross-border disputes. The Ministry of Corporate Affairs (MCA) on January, 2020 constituted Cross-Border Insolvency Rules and Regulations Committee (CBIRC), which submitted its Report in June, 2020.[9] The committee suggested that financial service providers and businesses providing vital financial, utility, and infrastructural services be excluded from Draft Part Z. Additionally, it suggested that 'foreign companies' be defined under Draft Part Z. Through clause 21, 22, and 23 of the Draft Part Z, the ILC advocated the need for a suitable structure to promote communication and cooperation in its Second Report from March, 2018.[10] The adoption of the various existing Guidelines for Communication and Cooperation amongst Courts in Cross-Border Insolvency Matters was particularly advised by the CBIRC in its own Report. The CBIRC noted the principles set forth by the Judicial Insolvency Network 2019 among others, notably the availability of a 'Facilitator', while also endorsing the ILC's proposals.[11]

The CBIRC recognised the potential irregularities caused by the IBC's exclusion of international corporations and foreign LLPs. The CBIRC therefore advised that the IBC's provisions be made applicable to entities:[12]

(a) that are formed with limited liability under the laws of a foreign nation; and
(b) have an establishment in India, as defined in Part Z.

There have been judicial attempts at recognizing cross-border insolvency resolution in India, especially in the landmark and much celebrated judgement of *Jet Airways (India) Limited v. State Bank of India & Another*[13] wherein cross-border insolvency resolution was allowed by way of 'joint corporate insolvency resolution process (CIRP)' in a dispute relating to powers of the Netherland Courts to try a dispute relating to bankruptcy proceedings of an airline, incorporated and registered in India. The decision of the National Company Law Appellate Tribunal (NCLAT) in allowing the Administrator appointed by the Dutch Court (where the proceedings had already been initiated and the Dutch Court was exercising jurisdiction under section 2(4) of the Dutch Bankruptcy Act) to participate in the CoC meetings (limited participation) was a welcome step. Such a decision of the NCLAT, while setting aside the order of NCLT refusing to withhold Indian CIRP proceedings, allowed greater cooperation between the Indian Resolution Professional and the Dutch Administrator and a consequent successful resolution plan in the interest of all stakeholders.

In her Budget Speech of 2022, the Finance Minister, Smt. Nirmala Sitharaman stated that in order to facilitate cross-border insolvency resolution, necessary amendments in the Code would have to be carried out not just to facilitate cross-border transactions, but also in the larger scheme of enhancing the efficacy of the resolution process. The reason for absence of a strong and efficient cross-border insolvency resolution process could be attributed to lack of institutional capacity or absence of a robust bankruptcy ecosystem, however, the incidental benefits associated with the introduction could far outweigh the inhibition and skepticism associated with it, whether in terms of increase in FDI, increase in cross-border trade or better ranking in the Ease of Doing Business Index, which saw a change in ranking after adoption of the Code.

INTERNATIONAL PRACTICE

In UK, the UNCITRAL Model Law finds incorporation through the Cross Border Insolvency Regulations, 2006. The extra-territorial nature of application of insolvency laws is seen by way of extra-territorial application of laws like UK Insolvency Act, 1986[14] (Insolvency Act). Section 221 and section 225 of the said Act, confers jurisdiction upon English courts even with respect to foreign companies, or companies not registered under Companies Act.[15] For instance, section 221 grants jurisdiction upon the English courts with respect to companies not registered under the UK Companies Act, in matters of winding up of such companies and confers power to make a winding up order.[16] However, the exercise of such discretionary powers depends on judicial discretion, being a circumstantial determination depending on factors like obvious benefit, something to administer etc. as held in the case of *JSC Bank of Moscow v. Kekhman* (2014).[17] Further, under Part 26 of the Companies Act, 2006, in matters of restructuring of debt of financially distressed entities, the courts have been empowered with a jurisdiction to sanction, with respect to such financially distressed entity, a scheme of arrangement. This jurisdiction vests with courts with respect to a foreign registered Company.[18] The UK courts could also play a subsidiary or ancillary role. Similarly, in matters of restructuring or liquidation, the US exercises extra-territorial jurisdiction by way of provisions in the US Bankruptcy Code, particularly Chapter 7 in matters of liquidation, and Chapter 11 in matters of restructuring provisions. The scope of bankruptcy estate under the US Bankruptcy Code extends to property of the debtor situated anywhere throughout the world. The jurisdiction under the Bankruptcy Code could be even invoked on the basis of a single bank account in the US, however the discretion lies with the judiciary which could refuse exercising jurisdiction in some situations. In the case of *Re Yukos*,[19] the jurisdiction with the Courts was held to be established on the ground of a bank account that was opened shortly before the bankruptcy proceedings were filed and on the ground of presence of the chief financial officer of the debtor in US. Even though the proceedings were subsequently dismissed on other grounds (section 112(b) of the US Bankruptcy Code), the validity of exercising jurisdiction on the ground of presence of a bank account was not affected.

ISSUES

A need was felt for incorporation of Draft Part Z in light of the Model Law, since provisions in the Code, namely section 234 and section 235 of the Code were not comprehensive enough.[20] However, upon an examination of the Draft Part Z, certain issues come to the forefront. One of the main issues associated with Cross-Border Insolvency is determination of 'center of main interest' (COMI). The classification of the two kinds of proceedings recognised by the Model Law, that is, 'foreign main proceeding' and 'foreign non-main proceeding' is premised on the presence of COMI of the corporate debtor (CD). Under the Model Law, 'foreign main proceedings' exists where the corporate person has its COMI and 'foreign non-main proceeding' where the corporate person has its establishment. The Model Law provides for the 'registered office' of the CD as COMI, which is a rebuttable presumption. The Draft Part Z law that is premised upon the Model Law, provides for the similar concept of rebuttable presumption that the registered office of the corporate person would be the COMI, however, no guiding factors or interpretations that would aid such determination exist. The issues pertaining to COMI also differs with jurisdictions, where other jurisdictions suggest an indicative list of factors for determination of COMI whereas the Draft Part Z states that the place of registered office of the CD could be considered as COMI, which is a rebuttable presumption. Chapter 15 of the US Bankruptcy Code provides for presumption of COMI, that is, the debtor's registered office as the COMI, and treats it as merely indicative.[21] Though EU provides for the presumption of registered office as being the COMI, and provides for a similar rebuttable presumption as Draft Part Z, two additional factors help in ascertainment of COMI, such as:[22]

a) Assessing the central administration of the Company located at a place other than its registered office.
b) That the third parties can determine that the actual centre of management and supervision of the company is located in another jurisdiction.

Further examination of the Draft Part Z reveals absence of clarity on 'public policy exception'. Where clause 4 confers a discretion upon the Adjudicating Authority (AA) to refuse an action on public policy grounds, the scope of what could be considered as being 'manifestly contrary to the public policy of India' is not known.[23] The power to determine factors for such ascertainment lies with the Central Government, which appears to be uncertain since the ambit of 'public policy' is wide and undefined. This highlights the vague nature of the provision providing for ascertainment of public policy exception and the power of the AA of refusal on this ground. However, determination of what would constitute as against public policy is well-settled in other jurisdictions. In EU, in the case of *Krombach v. Bamberski,* the European Court of Justice has held that as per the Brussels I Regulation, which relates to the recognition and enforcement of foreign judgements, for the 'public policy' exception to apply, a judgement would have to be at variance with the legal order of the country to an unacceptable degree.[24] The Court held as follows:

> … be at variance to an unacceptable degree with the legal order of the (enforcing country) in as much as it infringes a fundamental principle and the infringement would have to constitute a manifest breach of a rule of law regarded as essential in the legal order of the (enforcing country) of a right recognised as being fundamental within that order.[25]

Similarly, in the US, the 'public policy' exception is denied application by the US Courts with respect to enforcement of foreign judgements where the wrongdoer seeks for enforcement of a judgement occurring in the context of his wrongdoing .[26]

a) Where the judgement is incompatible with the Constitution of US or,
b) Where the judgement to be enforced is penal in nature.

The grounds of application of 'public policy' exception or refusal of enforcement on the ground of 'public policy' are settled in some other jurisdictions, which lacks and would constitute a legislative void if the Draft Part Z is incorporated.

The Draft Part Z appears to be a set of empowering provisions, however, the execution and enforceability of some of the provisions needs to be addressed in order to bolster Draft Part Z and consequently, the Code as a comprehensive part for dealing with cross-border insolvencies. For instance, clause 7(2) provides for a provision of Code of Conduct where it states that the foreign representative would be subjected to a Code of Conduct however the efficacy of such a Code of Conduct and consequent powers arising out of it in case of its violation, remains a question to be answered.

The way Draft Part Z has been worded, might come across as a result of adherence and compliance with the Model Law, however, it's incorporation in the Code, so as to become a part of domestic legislations, might be inconsistent with some erstwhile domestic provisions. Clause 13(1) of the Draft Part Z confers power on the AA to presume a proceeding as a 'foreign proceeding' and recognition of a person or a body as a 'foreign representative' upon production of documents and adherence with the manner as has been provided under section 12(2).[27] However, such a provision on presumption concerning recognition, confers a kind of presumption on the AA that appears to be a discretionary presumption. Clause 13(2) states that the AA would be 'entitled to presume' after conditions prescribed therein have been fulfilled. This provision providing that the 'AA' would be 'entitled to presume' would be equivalent to the 'may presumption' existing under domestic laws. Clause 13(2) further provides that, even though the documents in support of application have not been legalized, the power with the AA of being 'entitled to presume' subsists.[28] In order to bring it more in line with domestic legislation like section 14 of the Code of Civil Procedure, 1908 that provides for presumption as to foreign judgements, it would be a better approach to tweak the provision under the Draft Part Z and make it a 'shall presumption' for the sake of legislative consistency and clarity. Similarly, the 'principle of reciprocity' which is inculcated in the Draft Part Z on the basis of principles of Model Law, is not quite clear in the Indian jurisdiction as compared to other jurisdictions. For instance, the principle of reciprocity as followed in South Africa is much clearer where it provides for a notification of those jurisdictions, where the foreign representatives of those jurisdictions would be allowed to use their enactment, that is, the South African Cross Border Insolvency Act, 2000.[29] However, for a jurisdiction to be considered in such notification, it would be important for that jurisdiction under its law, to grant recognition to proceedings under the South African Cross Border Insolvency Act justifying the principle of reciprocity.[30] New Zealand provides safeguards to debtors and creditors of their nation as the principle of reciprocity is based on agreement between the two countries providing for mutual recognition of the respective insolvency proceedings.[31] However, there are some other countries which might not adhere with the principle of reciprocity in *stricto sensu* but deal with it on a case to case basis, such as the US and UK.[32] Thus, there's a greater clarity needed on the concept of reciprocity in the Draft Part Z and on the issues arising therein.

CONCLUSION

In view of the foregoing discussion, it is imperative that necessary changes are made and that Draft Part Z be tweaked to bring it in tune with other jurisdictions that have been able to successfully conclude cross-border insolvency resolution. In matters relating to determination of COMI, it has even been suggested by the Confederation of Indian Industry that an indicative list of factors is provided along with a proposed timeline for determination of COMI by the AA.[33] In matters of international cooperation and uniformity in law, certain necessary changes are needed such as clarity on the 'public policy' exception in the Draft Part Z, to minimise chances of arbitrariness and promote reasonable and justified exercise of discretionary powers by the AA under section 4 of the Draft. Similar clarity provided in other domestic legislation could be a useful guide in bringing the required changes. For instance, The Arbitration and Conciliation Act, 1996 provides for the grounds to be considered against public policy, that is:

a) Where the award is induced by corruption, fraud, or in violation of section 75, and 81 of the Act
b) Against the fundamental policy of Indian law
c) It is in conflict with basic notions of morality or justice.

It should be realised that concluding bilateral agreements between countries under section 234 of the Code could yield better cooperation and mutual assistance in matters of disputes arising under a cross-border insolvency process. Such agreements need to be arrived at to facilitate the process under the cross-border insolvency such as the one seen in the successful case of *Jet Airways (India) Limited v. State Bank of India & Another.*[34] However, we also do not take into account such other implementation impediments, such as absence of bilateral treaties where no recourse would be available or that the task of entering into bilateral treaties would involve lengthy negotiations and differing terms of incorporation varying with different nations. In the absence of bilateral treaties, it is important to have a uniform law under the guiding light of the Model Law. As per clause 7(2) of the Draft Part Z, the foreign representatives are to be subjected to a Code of Conduct, however, the efficacy of such a Code of Conduct or powers with the authorities under the Draft Part Z or the regulator, such as the Insolvency and Bankruptcy Board of India (IBBI), in case of violation of the Code of Conduct is questionable. In order to take an action against the foreign representative, it is not only required to provide for it under the Code of Conduct, but also to provide for it under bilateral agreements to be entered into between two nations as per section 234 of the Code. The latter would require tough negotiations and international cooperation, which could be a difficult path to tread. The need of a Code of Conduct with respect to foreign representatives was broached in a discussion on 'Cross Border Insolvency and Global Lessons for India', where it was suggested that such foreign representatives could be registered with IBBI and be subject to disciplinary proceedings and other requirements. However, subjecting foreign representatives to such domestic disciplinary proceedings would be no easy task since it would involve delving over issues of registration and monitoring of such foreign representatives, which appears to be in the realm of legal utopia, if one comparatively considers this issue in light of other complexities arising under a cross-border insolvency mechanism. Introduction of a cross-border insolvency mechanism is an issue whose importance cannot be ignored, however, before the time is ripe, it is necessary to introduce relevant changes in Draft Part Z, so that its introduction only strengthens and adds to a strong bankruptcy ecosystem rather than contributing to complexities in the path of a successful resolution.

[1] Notice by Ministry of Corporate Affairs, Invitation of comments from public on Cross-Border Insolvency under Insolvency and Bankruptcy Code, 2016, File No. 30/27/2018, Insolvency Section, Government of India, Ministry of Corporate Affairs, November, 2021, p.2.
[2] Interim Report of the Bankruptcy Law Reform Committee, February, 2015.
[3] *Ibid.*
[4] Status: UNCITRAL Model Law on Cross Border Insolvency (1997), United Nations, United Nations Commission on International Trade Law
[5] Supra Note 1.
[6] Arora M. and Kumar R. (2021), "India's tryst with cross border insolvency law: How series of judicial pronouncements pave the way?", SCC Online Blog.
[7] Supra Note 1.
[8] *Ibid.*
[9] Cross Border Insolvency Rules/Regulations Committee (CBIRC), Ministry of Corporate Affairs, Report on the rules and regulations for cross-border insolvency resolution, June, 2020, pp. 9-12.
[10] *Ibid.*
[11] *Ibid.*
[12] *Ibid.*
[13] *Jet Airways (India) Limited v. State Bank of India & Another*, CA No 707 of 2019.
[14] McCormack G. (2023), "Extra-territoriality and the UK Insolvency Act 1986", Legal Studies, p. 9.
[15] *Ibid.*
[16] *Ibid.*
[17] *Ibid.*
[18] *Ibid.*
[19] *Ibid.*
[20] Supra Note 1.
[21] Kumar R. (2021), "Understanding Cross Border Insolvency: An Indian Overview", Jus Corpus Law Journal, Volume 1, Issue 3.
[22] Report by Confederation of Indian Industry on Cross-Border and Personal Insolvency in India, Roadmap for Implementation, March 2019, pp. 13-14.
[23] Clause 4(1), Draft Part Z.
[24] Supra Note 22, pp. 16-20.
[25] *Ibid.*
[26] *Ibid.*
[27] Clause 13(2), Draft Part Z.
[28] *Ibid.*
[29] Supra Note 24.
[30] *Ibid.*
[31] *Ibid.*
[32] *Ibid.*
[33] Supra Note 21.
[34] Supra Note 13.

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The Scope of Mediation in IBC, 2016: An Analysis

- Aakriti Pandey Mishra and Abhas Mishra

INTRODUCTION

In India, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a distinctive legislation that consolidates and reforms the statutes relating to reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals. The Code is intended to assure that insolvencies are settled in an appropriate time frame and to preserve all stakeholders' interests, including creditors, debtors, and workers.[1] It established a precise structure as well as a time-bound insolvency resolution process. This Code is a fundamental reform that is supposed to make businesses in India easier by simplifying the settlement of distressed assets and encouraging entrepreneurship.

The enactment of IBC has proven to be a landmark in terms of resolving financial disputes across the country at a much swifter rate. The Code has proven to be an imperative piece of legislation by fulfilling the vacuum of fast-track dispute resolution for financial creditors (FCs), operational creditors (OCs) and corporate debtors (CDs). The Code has evolved from its predecessors, i.e., the Companies Act,[2] and the Sick Industrial Companies Act[3] which were proven to be insufficient and inadequate for resolving the liquidation and insolvency disputes. There have been considerable advancements in the insolvency resolution procedure since the establishment of this Code. It has significantly improved efficiency and effectiveness in resolving disputes via a mechanism called 'corporate insolvency resolution process' (CIRP).[4] It is an authorised and time-bound procedure that commences when a CD (i.e., a company or a firm) becomes insolvent, unable to pay its debts. The fundamental goal of CIRP is to promote a transparent and organised settlement of the company's financial difficulty while preserving the interests of all parties involved, including creditors, owners, and workers.[5] It has also contributed to increased investor confidence and economic growth. The Code has established a clear and transparent framework for insolvency resolution, as well as a levelled the playing field for all parties, including creditors and debtors. Furthermore, it has also reduced the strain on the courts by providing a fast and cost-effective method for resolving disputes. The Code has proven to be an imperative catalyst for the Indian economy, enhancing the business climate and spurring economic development and financial stability.

No doubt, the IBC was able to achieve the milestone of providing a swift resolution mechanism, however, in the post COVID-19 era, the Code encountered a significant challenge due to the pendency of abundant cases, the company law tribunals could not resolve disputes within a standard specified time frame which was maximum of 330 days (including the extension & litigation period)[6] as specified in the Code. The period could be extended beyond the specified time frame only in exceptional cases. While the lockdown era of the pandemic is behind us, an imminent requirement for faster resolution in insolvency and bankruptcy cases arose and this time not just for a swift disposal of cases but to significantly decrease the burden of the tribunals as well. The most obvious solution to this conundrum is the introduction of Alternative Dispute Resolution (ADR) mechanisms. It is trite that within the realm of ADR mechanisms, the most appropriate method is Mediation. Joseph Grynbaum, a world-renowned Mediator has famously said, '*An ounce of mediation is worth a pound of arbitration and a ton of litigation*'. Whilst as on date, there is no standalone legislation for mediation in India, there are several statutes containing mediation provisions, such as the Civil Procedure Code, 1908; the Arbitration & Conciliation Act, 1996; the Companies Act, 2013, the Commercial Courts Act, 2015, and the Consumer Protection Act, 2019. Even though the last two decades have seen mediation develop as apt tool to tackle matrimonial, succession and labour disputes, it is only in recent times, mediation has emerged as the go to mechanism for dispute resolution even in contractual, intellectual property rights and commercial matters.

In India, particularly in Delhi and Bengaluru, Civil Courts have been encouraging the use of mediation to divert appropriate cases for full, final and satisfactory resolution of all sorts of commercial disputes. While the prime motivator for judges was to decongest the dockets, many judges have themselves undergone mediation training and are now avid supporters of mediation even in complex matters. As mediation was paving its way in India to resolve the socio-economic and civil disputes, it was evident that insolvency and bankruptcy cases should also follow suite and explore the possibility of incorporating and employing mediation in insolvency proceedings. While the IBC was formulated in 2016 and proved to be imperative legislation, countries like Singapore and USA were already ahead with resolving the disputes of insolvency and bankruptcy *via* meditation. In 2017, the Singapore Government proposed mediation for insolvency and bankruptcy cases thereby overriding the previously adopted regime of English law. The Government even encouraged the resolution of cross-border disputes *via* mediation. In Singapore, resolution of individual creditor disputes with the debtor (in the context of a multi-creditor restructuring), or to manage multiple creditor disputes of the same nature (Similar Claims Mediation) are resolved with the help of mediation. In Similar Claims Mediation, a Mediator is typically appointed to facilitate the resolution of multiple claims with a common nexus of law or fact. In the US, insolvency proceedings for Lehman Brothers Inc., a structured mediation protocol led to the expedient resolution of the majority of derivatives- related claims, involving derivatives contract-related termination disputes and claims involving over 6,000 derivative contracts with 9,00,000 underlying transactions.[7]

RESOLVING IBC QUANDARIES: MEDIATION AS THE KEY

Mediation as an alternative resolution practice[8] will certainly be an aid to the existing IBC and reduce the burden on tribunals as well. As a matter of fact, one view is that even though there is no specific provision for mediation in IBC, the same is still not alien to the enactment and Rule 11 of the NCLT Rules, 2016 gives inherent powers to the tribunals (Adjudicatory Authority) to refer the matter to mediation. A case in point is *V.K. Parvinder Singh v. Intec Capital Ltd. & Anr.*, (NCLAT No. 968 of 2019), wherein promoters were ready to settle the claims of FCs by appointment of Mediator by the Appellate Tribunal. The National Company Law Appellate Tribunal (NCLAT) allowed the mediation by consent of parties and settlement terms were entered which were placed before the Tribunal. NCLAT relied on *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*, (Writ Petition (Civil) No. 99 of 2018) and in exercise of power conferred under Rule 11 of NCLAT Rules, 2016, set aside the CIRP.

Mediation can significantly reduce the rigid process as compared to litigation and result in a swift and satisfactory resolution among the parties which will also reduce the burden on the tribunals as well. Currently, no comprehensive statistical data to support or corroborate on use and success rates of mediation process in insolvency or bankruptcy disputes is available in India. However, one can turn to other jurisdictions that have embraced mediation in the insolvency proceedings. Initially, Singapore resorted to mediation for certain matters only but that paved the way for the compliance of mediation in the country which proved to be a paramount move and later imitated by other countries as well. In Australia, Court proceedings that involve recoveries of unfair preference payments or an insolvency trading claim against a director would require the applicant to file a Genuine Steps Statement that includes consideration or participation in the ADR and non-cooperation or failure to mediate in good faith may result in imposition of costs.[9] Mediation allows both parties to work together with the help of a neutral third party to reach a mutually agreeable solution. This can save time, and money, and preserve the relationship between the parties.[10]

India has already taken significant steps to inculcate the practice of mediation within certain spheres of the statutes (i.e., Commercial Courts Act,[11,] Civil Procedure Code,[12] Consumer Protection Act[13] & Arbitration and Conciliation Act[14]) but the roadblock which lies ahead is the implementation of mediation in specialised and time bound procedures such as the CIRP in IBC. The challenge is that the training of Mediators in India is not as specialised compared to the other countries and could be considered as one of the reasons that while drafting the IBC, the Committee that prepared the draft did not consider invoking a provision of mediation as an option to settle disputes. Nevertheless, since then

India has already become one of the first signatories to the United Nations Convention on International Settlement Agreements Resulting from Mediation or the Singapore Convention.[15] Unfortunately, it is yet to be ratified by India, however, mediation altogether has proven to be a more cogent approach for dispute settlements including cross broader disputes. Therefore, India is set out to introduce the Mediation Bill[16] and one of the foremost conundrums that the drafters are facing is whether the pre-mediation should be mandated before the parties can file a suit in the court. The answer to this is quite argumentative, however, a significant approach to this challenge could be placing the option of mediation as an alternative left to the discretion of the Bench of the Tribunal. The only caveat is that the Members of the Tribunal ought to be sensitised and trained to the effectiveness and nuances of mediation. Another solution could be to have a special list of disputes where pre-litigation can be made mandatory in absence of requirement of an urgent relief. This proposed resolution can serve as a 'test run' to see if mediation can work out in the CIRP. Next step to ensure a swift and satisfactory resolution from mediation is to ensure simultaneous, cogent and coherent training of the Mediators. For instance, the District Court in Amsterdam started a pilot project for mediation in bankruptcy liquidation cases. Though in nascent stage, the pilot project appears as a welcoming step and a foundation for development of subsequent comprehensive legal framework.[17] The aim of the pilot study was to investigate whether insolvency can be solved more quickly and at lower cost through mediation, so as to preserve a greater proportion of the debtor's estate for the benefit of the creditors.[18]

In India, the authors submit that such projects can be encouraged at NCLT level to analyse the scope of mediation in present regime of insolvency resolution. Foreign countries that possess a well-settled position on mediation (such as Singapore & USA) started by resorting to mediation only in certain cases and later resorting to a larger scale. However, in India, the commercial disputes falling under the Commercial Courts Act, 2015 necessarily have to go for pre-litigation mediation as per section 12A. In the case of *Patil Automation Private Ltd v. Rakheja Engineers Private Limited,* 2022 [Arising out of SLP (C)No. 14697 of 2021]. The Hon'ble Supreme Court of India ruled that obligatory pre-litigation mediation under section 12A of the Commercial Courts Act of 2015 is an essential requirement. Any litigation filed in violation of the aforementioned section must result in the plaint being rejected under Order VII Rule 11 of the Civil Procedure Code, 1908. The court may even exercise this authority *suo moto.* Therefore, there is every reason to believe that at least some disputes whether of a particular type or of a particular monetary denomination, ought to be sent for mandated mediation for a specific time period (say 30 days plus another 60 days with the leave of the Court/Tribunal) Preamble to the Singapore

Convention, talks about mediation as '*increasingly used in international and domestic commercial practice as an alternative to litigation*'. The Model Law under the Singapore Convention specifically states that the term 'commercial' should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; and carriage of goods or passengers by air, sea, rail or road.[19] This is imperative for India which is known as one of the leading nations to have widespread case backlog and pendency rate. Data shows that in the year 2022, the total number of pending cases was five crores, including over 1,69,000 court cases pending for more than 30 years in district and High courts. 4.13 crore or almost 85% of these cases are pending in district courts as of December, 2022.[20] It is sometimes also felt that once the matter reaches the courts, the participation of the affected parties is limited to the extent of giving testimonies. To tackle the menace of backlog, pendency and lack of citizen partnership, the Government of India introduced the Mediation Bill. The Mediation Bill comprises of 65 clauses and 10 schedules. It extensively covers several areas including contours of institutional mediation, establishment of a regulatory body, recognition of entities conducting mediation, role, qualifications and training of Mediators, online mediation, community mediation, settlement of cross-border disputes through mediation, compulsory pre-litigation mediation and enforcement of mediated settlement agreements.

However, there are voices of dissent within the legal fraternity, who believe that the process of mediation is nothing but a hindrance to the CIRP and would achieve no fruitful result other than delaying the proceedings beyond the designated period of 270 days which they hold sacrosanct. Some believe that if mediation is made compulsory, it will be antithetical to the idea of mediation and in conflict with the IBC.[21] These detractors lose sight of the fact that the situation of pending cases in IBC matters is no better. A total of 12,871 cases were pending under IBC as on October 31, 2022.[22]

In view of the above, the authors submit that the absence of comprehensive statistical data on the use and success rates of mediation in insolvency disputes and other commercial matters highlights the need for further exploration. It is only after mediation is introduced, *albeit* in a phased manner, that one can gather more data and insights into the effectiveness of this ADR method in the insolvency context. However, it will be apposite to mention herein that similar hesitation was shown by the legal community two decades ago when mediation was introduced in the civil courts. However, slowly the acceptance of mediation as means to dispute resolution gained prominence. According to Vidhi Centre for Legal Policy Report on Strengthening Mediation in India, 64.71% of all court referred mediations resulted in a successful mediated settlement.[23] In Delhi, out of total 28,804 cases where mediation started, 18,487 cases have been settled.[24] The success rate of mediation is therefore, highly satisfactory as roughly two out of three matters that were referred to mediation, resulted in settlement. In so far as pre-institution matters are concerned, the rate of success is roughly 25% for the Delhi High Court Mediation Centre.[25]

Secondly, the IBC primarily focuses on insolvency resolution, aiming to protect the interests of all stakeholders and ensure the revival of the CD. Mediation can complement this approach by providing a platform for parties to collaboratively reach mutually agreeable solutions. This aligns with the objective of corporate rescue and protection from corporate death by liquidation. Mediation is not adversarial to the CD's interests; it is, in fact, protective of its well-being. Mediation allows for creative solutions that may not be available through litigation, potentially leading to outcomes that safeguard the CD's viability. Authors suggest that it is advisable to identify the right kind of disputes to be referred to mediation. Disputes that involve debt restructuring (between FC and CD), employee claims, supplier-vendor disputes (between OC and CD), contract disputes or even preference actions are all fit cases where mediation can effectively help parties find mutually acceptable solutions to avoid insolvency or bankruptcy. However, cases that involve an element of fraud, extortionate credit transactions, regulatory compliance and payment of tax or has hostile and non-cooperating parties are disputes that are not ideal for mediation. In such cases, mediation should not be made compulsory. Thirdly, timely resolution of insolvency disputes supports the development of credit markets by maintaining the value of assets and ensuring that workers are paid, creditors are repaid, and investors can maximize their investments. Mediation, by its nature, encourages efficient and constructive discussions that can contribute to the timely revival of the CD. While the IBC has established strict timelines for insolvency resolution, it is possible to incorporate mediation without compromising the core objectives.

Mediation could be integrated at specific stages, such as pre-institution, where parties can explore settlement options without significantly disrupting the overall timeline. Mediation in insolvency proceedings could be designed in a way that complements the IBC's timelines. Mediation could run concurrently with certain procedural steps, potentially offering a chance for early resolution while ensuring that strict timelines are not unduly impacted. What is needed to make the mediations successful is an integration of the Mediation Law and IBC.

Ideally, there should be an amendment to the Code specifically adopting mediation. If Mediators can be trained by the Insolvency and Bankruptcy Board of India (IBBI), it will result in domain expert Mediators. There have been instances in other areas of law where a Mediator having domain knowledge, has been able to empower the parties to resolve their disputes and draw a fine settlement. Whilst a Mediator need not be an expert in the subject matter of dispute, he must have knowledge of the fundamental principles thereof and the legal position as it exists on the date when a dispute is being mediated. It is imperative and logical that if the mediation pertains to an infrastructure project, then in the absence of basic knowledge of infrastructure projects or contracts relating to supply, erection and commissioning of plant and machinery, it might be difficult for a Mediator to understand nuances of the dispute. In the case of *DLF v. Kunal Bakshi*[26] the Hon'ble Punjab & Haryana High Court in appointed a Mediator who had domain knowledge of real estate development and construction, and could therefore assist parties effectively in arriving at solutions acceptable to them and drafted a comprehensive mediation settlement.

Similarly, the authors propose that the IBBI may have its own panel of qualified Mediators who can undergo periodic training to remain abreast with the law and result in improvement both in the process of mediation and also in the quality of the settlement agreement. Trained Mediators will thus be able to ask the right questions of the parties at every stage of the process for effective communication also ensures that nothing is agreed in the mediated settlement which is contrary to any statutory provisions, principles of law or fundamental policy of the Code. Lastly, mediation can play a crucial role in reviving a distressed company as a going concern. By facilitating meaningful negotiations, mediation could lead to innovative solutions that may not be feasible within the confines of traditional litigation.

Mediation has proved to be an effective resolution mechanism in terms of insolvency and bankruptcy disputes which is even promoted by the courts nonetheless, the scope of mediation in India is still not at its apex as compared to the other countries. If prospectively mediation is applied in the current insolvency and bankruptcy cases, it can lay off a considerable amount of unnecessary litigation and save the time and money of the concerned parties whilst ensuring a swift and coherent resolution. Incorporating mediation in insolvency proceedings within the IBC framework, while carefully considering the impact on timelines, can serve to explore out-of-court settlements, creative solutions, and more equitable outcomes for all stakeholders involved. While preserving the core objectives of the IBC, mediation could potentially enhance the insolvency resolution process and contribute to the overall goals of corporate rescue and economic growth.

CONCLUSION

Mediation is emerging as a viable solution to address the challenges faced by the IBC. Countries like Singapore, Belgium, England, France, Greece, Spain and the USA have already embraced mediation for resolving insolvency and bankruptcy cases, showcasing its effectiveness in reducing the burden on courts and providing swift and satisfactory resolutions. Encouragingly, India has recognized the benefits of mediation and has incorporated it into certain spheres of law, but there is still room for improvement and wider implementation.

Within the interplay of the Mediation Bill and IBC potential conflicts surface as a central concern. Notably, discrepancies may arise in terms of the enforceability of mediated settlements and the delineation of mediation's scope. The Mediation Bill, being a comprehensive legislative framework, seeks to govern a wide array of disputes encompassing civil matters, including contracts, familial conflicts, and more. In contrast, the IBC operates within the specific and specialised domain of corporate insolvency, focusing on the resolution of complex financial intricacies.

These conflicts, often underpinned by jurisdictional challenges, pose questions about the hierarchy of these two legal frameworks when dealing with disputes that encompass elements of both legislations. Furthermore, the distinct roles and responsibilities ascribed to Mediators in the Mediation Bill and Resolution Professionals in the IBC may create overlaps or contradictions, necessitating careful navigation to ensure a harmonious application of both. There is also the question of hierarchy and participation of various creditors in the mediation process.

However, it's crucial to emphasize that these conflicts are not insurmountable. With a keen understanding of the nuanced jurisdictional boundaries and a judicious approach to the scope of mediation, practitioners adept in both domains can leverage the synergies effectively. For instance, mediation can substantially expedite negotiations in the IBC's pre-packaged insolvency resolution process, facilitating swift resolutions. Mediation can also be leveraged at the pre-institution stage, enabling the rescue and rehabilitation of distressed entities, reducing the burdensome caseload of tribunals, and realizing cost and time efficiencies. In order to effectively reconcile these mechanisms and fully leverage the potential of mediation, India must focus on two critical aspects:

a) The training of Mediators needs to be enhanced to ensure they possess the necessary skills and expertise to handle complex insolvency and bankruptcy cases effectively. Drawing inspiration from countries like Singapore and the USA, India can gradually expand the use of mediation in these cases.

b) In the process of enacting the proposed Mediation Bill, the Government must cogently consider the role of mediation in dispute resolution particularly in special legislations.

The judicious integration of mediation within the IBC framework is essential. This integration must encompass well-defined guidelines for mediation's application, its relationship with formal insolvency procedures, and alignment with the IBC's overarching goals and mechanisms for resolution and enforcement. Striking a balance between the advantages of mediation and the IBC's imperative for expeditious resolution is pivotal to seamless incorporation into insolvency and bankruptcy proceedings in India. Introducing mediation as an alternative before initiating formal legal proceedings for certain class of disputes can serve as a test run to evaluate its effectiveness. By doing so, parties involved in disputes will have the choice to opt for mediation or litigation, thereby providing flexibility and encouraging more parties to embrace this dispute-resolution mechanism. The rise of mediation would mean the end of adversarial litigation was near as opined by Justice P.S Narasimha.[27]

Moreover, India could also look at judicial interventions like those seen in the *Patil Automation Private Ltd v. Rakheja Engineers Private Limited* case,[28] where the courts mandated pre-litigation mediation under specific circumstances. Such initiatives can further boost the use of mediation in resolving disputes, including insolvency and bankruptcy cases.

In conclusion, mediation has the potential to be a valuable tool in resolving insolvency and bankruptcy disputes in India. By embracing mediation and incorporating it into the existing legal framework, India can further expedite the resolution process, reduce the burden on tribunals, save time and money for all the stakeholders involved, and promote a more cooperative and amicable approach to dispute resolution.

As we stand at this crossroads of reform, it is imperative to acknowledge our past. While we may have missed the opportunity to become a global hub for arbitration, this should not deter us from fully embracing mediation. This is our chance to chart a different course, leveraging mediation's unique attributes to propel us towards becoming a regional and global leader in this increasingly important field.

In a world where adaptability is key, India has the potential to become a beacon of innovative mediation practices, setting new benchmarks for resolving complex insolvency and bankruptcy disputes. By seizing this moment and channelling our resources into fostering a mediation culture, we not only contribute to expeditious and effective dispute resolution but also strengthen our position as a progressive and trusted destination for businesses seeking fair and constructive solutions.

Lastly, the authors submit that the past must not dictate the future. Through a deliberate and concerted effort to prioritize mediation, we could not only bridge the gap but also surpass expectations. It is time for India to harness the power of mediation to enhance its insolvency and bankruptcy resolution mechanism and reinforce its position as an investor-friendly and economically progressive nation. Let us capitalize on this potential and pave the way for India to shine as a global standard-bearer in mediation, enhancing our credibility, prosperity, and influence on the international stage.

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DATA PROTECTION AND IBC: A NEW FRONTIER?

- Debanshu Mukherjee and Neha Lodha

INDRODUCTION

Data privacy and personal data protection has been an evolving issue under the Indian legal framework in the recent years. Since the recognition of right to privacy as a part of right to life under Article 21 by the Supreme Court, there have been several developments to provide a statutory framework for recognition of this right and its operationalization in the Indian economy. Until recently, India did not have a standalone data protection legislation, however, in a recent development, the Digital Personal Data Protection Act, 2023 (DPDP Act) was passed.[1] The DPDP Act seeks to provide a statutory framework for the protection of digital personal data.[2] Introduction of this law has wide ranging implications for India's legal system and the market, and is bound to have a bearing on various economic legislations, including the Insolvency and Bankruptcy Code, 2016 (IBC/Code).

The insolvency, liquidation and bankruptcy processes under the Code involve processing and handling of both personal and non-personal data, which may include *inter alia* financial information of individuals, personal guarantors and corporate debtors (CDs), consumer data, valuation reports, and data of personnel, workmen and employees of the CDs. This data is accessed, processed and stored by several stakeholders involved in the insolvency proceedings, including Informational Utilities (IUs), Courts, Insolvency Professionals (IPs), creditors and the Insolvency and Bankruptcy Board of India (IBBI). Handling of such data during these processes not only has implications in terms of right to privacy of individuals but also has a bearing on the financial market. In past, concerns have been raised by courts and stakeholders about the storage and processing of data and maintaining confidentiality during these proceedings. In light of this, it is important that data protection norms that prevail in the legal system are suitably implemented when an individual, personal guarantor or a CD is undergoing processes under the Code. However, given such proceedings are governed by the objectives of value maximization and time bound resolution of assets, there is a need to balance out the strict implementation of all data protection norms and the duties required to be performed under the Code.

In the backdrop of the recent legal developments on data protection, this paper seeks to set out the interplay between DPDP Act along with other data protection principles applicable under India's legal framework and the processes under the Code. This interplay shall be based on the determination as to whether during the processes under the Code, the data in relation to an individual debtor or a CD shall be seen in terms of its property rights or contractual rights. This will determine the kind of claims that can be raised in respect of data protection. The main question sought to be addressed is in respect of categorisation of the data involved during the processes under the Code as per the statutory and constitutional framework on data protection prevailing in the country. This is then harmonised with the objectives of the Code. It further seeks to look at the evolution of data privacy norms in other jurisdictions and their interplay with the insolvency ecosystems to identify any potential conflicts that may arise in respect of data protection and the Code. It specifically seeks to look at the role of IBBI and IUs in upholding the data protection norms and analyses the practices adopted by the other regulators in the country for this purpose. Lastly, it suggests ways of harmonising the objective under the Code with the objectives of the DPDP Act. This paper is limited to the interaction between corporate insolvency resolution and liquidation processes with data protection law.

RIGHT TO PRIVACY IN INDIA: ANALYSIS FROM AN ECONOMIC LENS

The privacy debate gained traction in India in the second half of the last decade, with the recognition of right to privacy as a part of right to life under Article 21. In its decision in the case of *Justice K.S. Puttaswamy v. Union of India*,[3] the Supreme Court recognized the right to privacy as a fundamental right under Article 21 of the Constitution of India by a unanimous decision of a nine judge bench. Justice Nariman, while penning down his concurring judgement, noted that 'informational privacy' is a facet of the right to privacy, and that an individual has control over the dissemination of material which is personal to him. This was broadly in the context of the economic justification, that data belonging to an individual has some tangible value for that individual, which must be secured and protected as a right.[4] He further noted that in the modern age, an individual has a right '*to exclusively commercially exploit their identity and personal information, to control the information that is available about them on the 'world wide web' and to disseminate certain personal information for limited purposes alone*'.[5] As a corollary of this right, an individual also has the right to prevent others from using their identity and personal life for commercial purposes without their consent.[6]

Looking at the legal framework for data privacy from an economic lens, it becomes evident that there is some inherent value that is attached to any form of data.[7] Further, the processing of data to generate relevant databases and information for certain purposes requires usage of skill and labour and that also adds to this value.[8]

It is commonly understood that anything that has an exchangeable value or provides some monetisable benefits to an individual can be considered as property.[9] As a consequence, an analysis of data assets involves a discussion on whether they are considered to have the full extent of property rights associated with them.[10] Property may be categorised into tangible and intangible. While data exists in both forms, the concern about data protection is mainly in respect of the intangible sphere.[11] However, a key feature of any category of property is that it is freely transferable and has a determinable commercial value.[12] If data protection rights are understood as property rights, then it follows that there should be no fetters on their transfer.[13] Such a conceptualisation of data assets would have a bearing on the extent of regulation of such assets under the legal framework.

There is a global debate on the extent to which privacy rights should be commercialised. The advocates of a strict economic understanding of data privacy suggest that the most economically efficient form of data protection shall be where processing of data is only barred in cases where it is value destructive for an individual. In all other cases, it should be allowed to be freely exploited (commercially) as it would promote information symmetry and generation of value for multiple stakeholders. Such an understanding leads to categorisation of right to privacy as a property right, along with the full extent of ownership rights for its free transfer and commercialisation.[14] It is argued that this understanding of data privacy would reduce value destruction of data assets and align with the principle of value maximisation that drives insolvency regimes across jurisdictions. On the other end of the spectrum are advocates of a strict data protection regime. They conceptualise the right to privacy as an inviolable right of an individual.[15] Commercial exploitation of personal data is seen as its commodification which goes against the sacrosanct status conferred on it.[16]

Most jurisdictions while framing legislations on data protection seek to strike a balance between these two diametrically opposite approaches and assign data protection right the status of quasi-property rights.[17] Quasi-property rights provide an entitlement which is higher than that of a right *in personam*, but lower than right *in rem*. Such rights are hinged on entitlements based on relationships between the parties.[18] They are not fully transferable from one owner to another but can be used for a lawful purpose and for a pre-determined period.[19]

In the Indian legal context as well, property rights are considered to provide an entire range of exclusive rights of '*ownership, the unrestricted and exclusive right to a thing; the right to dispose of a thing in every legal way, to possess it; to use it, and to exclude everyone else from interfering with it...*'.[20] Categorisation of personal data assets as a property right would mean allowing free transferability, which goes against the conception of inviolable right of an individual as upheld in the *K.S. Puttaswamy* decision.[21] In view of this, the understanding of data privacy in the Indian context cannot be based on the traditional understanding of property rights. An analysis of the current legislative framework provides a better insight into the categorisation of data privacy in our legal context.

LEGISLATIVE FRAMEWORK ON DATA PRIVACY

Until recently, there was no separate legislation in force in the country which laid down a governance framework for data protection. The

Information Technology Act, 2000 (IT Act), which was enacted to streamline the processing and legalisation of electronic records contains certain provisions for protection of privacy and confidentiality of data and provides penalties for its misuse.[22] Specifically, under section 43A, a provision has been made to provide compensation for the failure in protection of sensitive personal data or information by a body corporate that owns a computer resource where such data is stored.[23] This provision is sought to be omitted by the DPDP Act.[24] Section 72 provides for a penalty for breach of privacy and confidentiality by a person who is in possession of electronic records by the virtue of the powers conferred under the IT Act.[25] Section 72A further penalises disclosure or dissemination of information without lawful consent or in breach of a lawful contract by an intermediary in possession of personal data.[26] Further, in 2011, the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules (SPDI Rules) were introduced for the purpose of protecting sensitive personal data of individuals which includes passwords, financial information, biometric information, medical records, etc.[27] It defines 'personal information' as any information that relates to a natural person, or information available with a body corporate that can either directly or indirectly, in combination with other information be traced back to a natural person.[28] It further imposes a duty on the persons or body corporates handling such personal data to adequately safeguard such data.[29] As evident, these provisions are fragmented and open ended and lack a comprehensive approach towards data privacy.

Discussions have been going on for several years to provide for a consolidated legislation for data protection in India. These discussions have finally culminated in passing of the DPDP Act by the Parliament. It applies to personal data that has been collected online or offline data that has been digitised.[30] Personal data is conceptualised as any data that relates to an identifiable individual.[31] The Act does not provide privacy protections in respect of non-personal data or data that is not in a digital format. The protection is with respect to processing of such data either in India or other jurisdictions.[32] Such data can be used only for lawful and legitimate purposes or with the consent of the individual who owns the data, called a 'data primary'.[33] Such consent is required to be specific, informed, for a limited purpose and for a limited period of time.[34] The persons involved in collecting, processing and storing such data are referred to as 'data fiduciaries'.[35] Data fiduciaries have a duty to regulate the processing of personal data in its possession and to ensure that the data is accurate, secure the data and delete it when its purpose has been fulfilled (in order to avoid indefinite access to personal data of data primaries).[36] The Act also imposes restrictions on processing of personal data outside of India.[37]

The legislations concerning data protection, privacy and confidentiality have historically contained certain exceptions to consent requirements when processing data for legitimate use or in public interest.[38] The DPDP Act also enables Central Government to provide exemptions from provisions of this Code on grounds of legitimate use, security of the State, public order, and prevention of offences.[39] Further, various exemptions have been provided for processing personal data for the purposes of exercise of a legal right or claim, or for performance of functions by judicial or regulatory bodies, to the extent that it is necessary.[40] A specific exemption is provided for processing data for the purposes of obtaining financial information in connection with a loan taken by 'financial institutions' as defined under the IBC in accordance with disclosure requirements under any other law for the time being in force.[41] An important right provided under the DPDP Act is the right to withdraw consent by a data principal at any point of time, thereby affecting its free transferability, which distinguishes property rights in data from other property rights.[42] If data fiduciaries could obtain an irrevocable consent from data principals at the time of collection of personal data, there was still a possibility of some extent of commercialisation but that has not been permitted. Further, the DPDP Act provides a range of stringent monetary penalties for any violations of its provisions which range from ten thousand rupees to two hundred and fifty crore rupees.

The design of the DPDP Act clearly indicates that the legislature aligns with the position taken by the judiciary to consider data privacy as a fundamental right and confers a quasi-property status to personal data assets in the Indian context by creating an entitlement based on the relationship between the data principal and the data fiduciary. Hence, any legislation that seeks to rely on free usage of the data for its purposes will have to be aligned with the DPDP Act. In light of this discussion, it may be relevant look at the instances under the Code, where personal data protection concerns become relevant.[43]

PROCESSING OF PERSONAL DATA UNDER THE CODE

The Code envisages processing of data and information at various stages and by multiple participants. There is a mandatory obligation on financial creditors (FCs) to submit financial records and information in respect of assets on which security interest is created with the IUs.[44] The Code also enables operational creditors (OCs) to submit information to IUs. It also allows such person to correct any errors in such information and bars them from sharing the information elsewhere unless otherwise permitted under the regulations.[45] The Code further imposes an obligation on IUs to create, store, accept and authenticate such information. It requires the IUs to maintain quality standards, ensure that the information stored is safe and accurate and provide access to such information in furtherance of the requirements under the Code.[46]

Such information is primarily utilized for determination of a default and admission of applications under section 7 and 9 of the Code.[47]

In the last few years, there has been a move to digitize the court processes, banking systems and information databases in the country. In furtherance of this objective, the Parliamentary Standing Committee on Finance, 2020-2021, in their report recommended further digitisation of IBC ecosystems and increased interoperability between NeSL, MCA 21, e-courts etc.[48] These recommendations were also made in the Insolvency Law Committee (ILC), in its Report in 2020, which explicitly stated that such digital platforms should comply with data privacy norms and have grievance redressal mechanisms for addressing complaints.[49] Further, the ILC in 2022 recommended an increased reliance on financial records submitted to IUs in establishing a default.[50] The Report of the Colloquium, 2022 recommends for mandating submission of records of dispute etc. to the IUs by OCs.[51] It also envisages establishment of an e-portal for processing all information in respect of the Code and establishing IUs.[52] Such developments indicate that there is an increasing reliance being placed on the digitised information for the processes under the Code.

Apart from collection and storing of information, data is also processed by other entities which include IPs, Liquidators, Insolvency Professional Agencies (IPAs), and persons authorised by them to perform certain functions under the Code. These entities have a duty under the Code to collect information about the debtor's assets, finances, liabilities, business operations etc.[53] They are also conferred with the custody of all business records and financial information of the CDs and are obligated to file them with the IUs.[54] They also share such information with the courts, committee of creditors (CoC) and the IBBI for various purposes under the Code. Further, the IBBI is empowered to regulate the conduct of IUs and IPs/IP entities, IPAs and Liquidators and provide guidelines for their functions.[55] IBBI is also entitled to collect and store information and publish it for the purposes under the Code.[56]

Data protection concerns also arise during the resolution and liquidation of the company when the resolution applicant or a new purchaser of the assets takes control over the company. In such cases, there is a need to safeguard third party data, customer data, information related to employees and key personnel. Further, there may be consent requirements to be met for transfer of such assets during these processes, if applicable.

There are various safeguards in place currently under the Code for protection of the information collected and processed at various instances, which are evaluated in the next section.

DATA PROTECTION UNDER THE CODE

Currently, there are various checks in place for maintaining confidentiality and restrictions on transferability of the information collected and processed under the Code. Under section 29(2), while sharing the information with the resolution applicant, a Resolution Professional is required to ensure compliance with laws pertaining to confidentiality, protection of intellectual property of the CD and to restrict sharing of such information with third parties.[57] An IP, except to the extent provided in the Code and the rules, regulations or circulars issued thereunder, is required to keep all information related to the CD confidential, and to restrict its disclosure to, and access by unauthorised persons.[58]

IBBI has issued various regulations for governing the functioning of IUs under the Code. These regulations provide for technical standards to be maintained while information is stored with IUs, which includes establishing a unique identification for each record, verification and authentication of information, consent framework for sharing information with third parties, securing the information and preserving and purging the information.[59] The IUs are also required to store such information in India.[60] IBBI has issued various guidelines setting out the details for maintenance of technical standards by IUs. They provide guidelines for a consent framework for identifying the primary identifier, start and end date of access to information and the purpose of providing information.[61]

While a detailed framework is applicable for storing of information and consent requirements by IUs, it is not available for other players in the ecosystem who handle personal data like IPs and advisors appointed by them, who are merely bound by a general obligation to maintain data confidentiality. Similarly, CDs, creditors and resolution applicants are bound by policies of other market regulators like SEBI, RBI etc. However, no set standards are available to ensure that transfer of data to resolution applicants and buyers of the assets is bound by data protection norms. Having said that, there is a requirement under section 30(2) of the Code that a resolution plan shall be compliant with all laws that are in force.[62] This would also require compliance with data privacy norms and legislations that are applicable to the CD’s assets, employees and personnel. It may be relevant here to look at the extent of data protection norms applicable to these other players under the Code, through other regulators.

DATA PROTECTION POLICIES OF OTHER REGULATORS

Various regulators in India have adopted a range of data protection norms to regulate processing of data by the entities working under their governance. SEBI has issued a comprehensive cybersecurity framework for stock brokers, depository participants, mutual funds and asset management companies. The policy provides for encryption of sensitive data that is stored or transferred, data masking, cyber security audits, vulnerability assessments, periodic upgrading of software and hardware and identification of critical assets.[63]

The RBI also requires banks to comply with the Cyber Security Framework in Banks, 2016, which mandates banks to adopt incident response management and recovery frameworks to deal with adverse incidents/ disruptions when they occur.[64] Similar guidelines have also been issued for non-banking financial institutions.[65] RBI also provides a customer service framework for imposing an obligation to maintain secrecy that arises out of the contractual relationship between a bank and the customers, and no information should be divulged to third parties except under well-defined circumstances. The exceptions to the rule of secrecy are, where disclosure is under compulsion of law in the interest of public or the bank or where there is an express or implied consent.[66] Further, when considering requests for data/information from the Government or other agencies, banks are required to satisfy themselves that the information being sought is not of such a nature as will violate the provisions of laws relating to secrecy in banking transactions.[67] There are various other financial legislations that provide for maintaining confidentiality and having a policy in place for disclosure of data.[68] Similarly regulators like IRDAI and TRAI have come up with frameworks which seek to ensure data encryption, disclosure and limitation of the purposes for which such data can be used.[69]

These policies would largely govern FCs, industry players, listed companies and asset management companies that act as stakeholders under the Code. There is broad general obligation of ensuring protection of data across all the regulators. However, unlisted and private companies, for instance, real estate companies may still remain largely under-regulated in so far as the issue of data protection is concerned. Further, even where policies exist, they do not directly address situations that arise during insolvency proceedings pertaining data protection and consent requirements on change in ownership of the company and transfer of assets, where applicable.

CONCERNS REGARDING IMPLICATIONS OF DPDP ACT ON THE CODE

The stringent consent requirements under the current DPDP Act and penalties therein may translate into increased liabilities for IPs, Liquidators and IUs. Further, it may lead to hindrances in transfer of a CD's ownership to a resolution applicant or transfer of its assets during the resolution or liquidation process. The IBBI, being the statutory regulator, shall have a direct exemption under the DPDP Act for processing of data necessary for its functions.[70] Similar exemptions may be extended to other regulated entities under the Code which include IU's IPs and other process advisors. However, the position becomes muddled in the context of utilisation of data that has been transferred pursuant to such processes. This might be a major cause of concern for insolvency proceedings involving technology based companies for which the major source of revenue is data aggregation, consolidation and processing.

While a strict compliance to data protection policy norms might be seen as going against the principle of value maximization under the Code,[71] given the status of right to privacy as a fundamental right, such compliances cannot be completely done away with. Further, concerns have been raised in the past about maintenance of confidentiality during corporate insolvency resolution process and data breaches while maintenance and disclosure of data under the Code.[72] Hence there is a need to balance privacy rights and the objectives under the Code.

In India, personal data is seen as quasi-property, and when posed with a conflict between right to privacy and objectives under the Code, the courts may lean towards keeping data protection on a higher pedestal in comparison to other statutory considerations. This may not auger well for the efficiency of the insolvency system. In the light of this momentum towards greater data protection in the country as evident from the enactment of the DPDP Act, there is an imminent need to align the Indian insolvency regime with the data protection framework without undermining the processes under the Code. At this juncture, it may be relevant to look at the experiences in other jurisdictions, where data privacy statutes have been introduced in recent times to understand the potential conflicts that may arise in the event of an insolvency or liquidation and the manner in which they can be resolved.

THE INTERPLAY OF INSOLVENCY AND PRIVACY LEGAL FRAMEWORK ACROSS JURISDICTIONS

The jurisprudence on the interplay between insolvency law and data protection norms is still evolving and there have been limited instances globally where the policies in this regard have been laid down concretely.

In the United States, there is no consolidated federal law that governs data protection and privacy. However, there are a number of sector-specific laws, such as the Gramm-Leach-Bliley Act (GLBA) and the Health Insurance Portability and Accountability Act that impose data protection requirements on certain industries. [73]

The GLBA, governs the privacy and security of personal financial information of consumers in the context of financial institutions. It sets out requirements for the protection of personal information held by financial institutions, which shall include those involved in insolvency matters. Under the GLBA, financial institutions are required to implement safeguards to protect the confidentiality of non-public personal information of consumers.[74] Further, during bankruptcy proceedings, a company is allowed to use, sell, or lease property of the estate, including customers' data, unless its privacy policy prohibits *'the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor'*.[75] If the company's privacy policy prohibits this transfer, a consumer privacy ombudsman must be appointed to review the facts of the sale and the applicable non-bankruptcy law. [76] Courts in US have strictly interpreted application of data privacy norms during insolvency proceedings. Restrictions have been imposed on the right to transfer of ownership of a company if the purchaser has not provided the same standard of privacy protection as that of the distressed company. These restrictions may affect the value of such assets.[77]

The European Union General Data Protection Regulation (GDPR) has been enforceable since May 2018 and is considered to provide the most stringent privacy protection guarantees globally. Under the GDPR, companies are now required to have privacy policies that include information regarding the recipients of customers' personal data, whether there is intent to transfer such data, and the right to withdraw consent to the processing of such data.[78] In light of such policies, there is greater degree of compliance that has to be undertaken by the IPs while dealing with the assets of distressed companies.[79] Courts in England have held that IPs are not responsible for any non-compliance with data privacy norms before the commencement of insolvency proceedings. However, when discretion is exercised by an IP as a data controller over personal data during insolvency or liquidation proceedings then it must be in compliance with data privacy norms and any claims in relation to it should be addressed during the proceedings.[80] The consent requirements also become relevant during the sale of assets of the company or the company itself. Hence, the GDPR is considered to have considerable risks for IPs and purchasers of distressed assets and can cause value depletion.[81]

This establishes a need to reflect on the various ways of harmonising conflicts that may arise under the Code creating an interface between the two laws.

ADDRESSING CONFLICTS BETWEEN THE CODE AND THE DPDP ACT

There are various potential conflicts that may arise during the processes under the Code. One of the first instances is submission of information to the IUs. As IUs use the data for the means and purposes of the processes under the Code and may be required to share it with third parties, they are likely to be categorised as data fiduciaries under the DPDP Act.[82] The Bankruptcy Law Reforms Committee (BLRC) while considering privacy concerns in relation to IUs had stated that:

There is a tension between legitimate concerns about privacy, and the gains to society from more open release of information. The position of the Committee on these questions favours partial public access to information about liabilities without identities at all times for listed entities, temporary access enabled by permission about liabilities without identities for unlisted entities, and complete release of information to participants of the insolvency resolution process when the process commences.[83]

The BLRC had taken an approach of providing greater information access as it is necessary for conducting the processes under the Code. Hence, processing and disclosure of such information by IUs should be considered as 'legitimate use' and may not attract any penalties.[84] Further, IUs may be protected under the exemption for processing data by bodies entrusted with supervisory and regulatory functions to the extent that such data is necessary to perform these functions.[85] An exemption is also available for disclosure of personal data for determination of a default in respect of a loan in accordance with applicable laws..[86] However, even after these exemptions, there shall be a duty on the IUs to maintain necessary safeguards to protect such data.[87] Currently, the technical standard guidelines applicable to the IUs require a detailed consent framework which has policies in place for obtaining consent, period of such consent and purging of data.[88] These may be further aligned to the DPDP Act to have more specific and defined consent and security safeguards and adequate mechanisms for redressal in case of any breaches.[89] Further as has been observed in the policies of other regulators, all such data and information should be encrypted and protected by passwords, PINs etc. in order to further secure it.

Similarly, given the concerns about liabilities under DPDP Act while performing duties under the Code the regulations for IPs (and their advisors) should provide for certain standards and safeguards to be maintained in line with the new law.[90] Arguably, IPs may be covered under the exemptions under the DPDP Act.[91] However, it may be relevant to define the extent of data required and the means needed to safeguard it (in the regulations), to make it abundantly clear that processing of such data, is 'necessary' for performance of their functions. It may not be possible to impose a requirement to obtain consent from the data principal for every disclosure or processing of data under the Code due to the process being time bound. However, adequate guidelines may have to be provided for the purposes and the period for which such information shall be accessed and used in order to ensure that it gets covered by the legitimate use exception and the exemptions under the DPDP Act.

As per the provisions of the Code, the resolution plan requires compliance with applicable laws, which would include compliance with the DPDP

Act and other data protection norms imposed on the CD by other regulators.[92] The DPDP Act may extend a protection to data processed during resolution or liquidation, however the duty to maintain safeguards shall be applicable.[93] In order to ensure smooth transfer of assets and to avoid value deterioration, it may be necessary to have certain data privacy compliance requirements under the resolution plan and during liquidation.

Another potential conflict may arise during an insolvency or liquidation process, when data may get transferred to another entity as an asset (for instance, customer data owned by the CD) and is sought to be utilised by the transferee or the purchaser. It is unclear if it shall be covered under the exemption for exercise of a legal right, albeit a case can be made.[94] In US and UK, courts have leaned towards a strict compliance of data privacy norms for data transferred during bankruptcy processes. For avoidance of similar concerns during the insolvency and liquidation processes under the Code, mechanisms should be in place to establish consent from the data principals. An obligation may be imposed on the data principal to provide or withdraw the consent to use personal data during the transfer of assets under the Code, which is in accordance with the principles under the DPDP Act.[95] This is to ensure that the resolution applicants and purchasers of assets (in liquidation) have sufficient leeway in utilising such data along with adequate protection of it.

Further, any prior data breaches by the CD will give rise to liabilities under the DPDP Act that might survive the insolvency resolution or liquidation proceedings. In light of this, it must be ensured that no liability in terms of any data breaches by the CD before commencement of the process shall pass on to the resolution applicant and the resolved CD after approval of a plan or to the purchasers of the assets after liquidation. Courts have evolved a clean slate theory for extinguishment of all liabilities on approval of a resolution plan by the Adjudicating Authority, which shall arguably cover such liabilities.[96] However, the issue of continuation of statutory liabilities after approval of a plan is still unsettled.[97] Given that the DPDP Act introduced a new set of liabilities, it must be ensured that the resolution plan has provisions to address the same to avoid litigation.

Further, going forward, CDs while drafting internal privacy policies, may secure specific consents for situations where an asset is transferred pursuant to proceedings under the Code in order to give adequate notice to the data principals and avoid legal hurdles and attract penalties on the stakeholder as a consequence of bankruptcy related outcomes. If debtors do not have the right incentives to have such policies in place voluntarily, creditors should consider requiring them to do so as part of their lending or contractual documents to mitigate against any adverse consequences or limitations on resolution options (under the new data protection regime) if the company were to become insolvent and becomes subject to proceedings under the Code.

CONCLUSION

Data privacy and insolvency legal frameworks appear to be in conflict with each other as a strict compliance with privacy norms might go against the principle of value maximization. However, with the statutory recognition of the right to privacy with the passing of the DPDP Act in the Parliament, it becomes important to ensure that such conflicts are minimized and the right to privacy is balanced against the economic benefits that are ensured by preservation of the value of a debtor's assets. An overview of the jurisprudence in other countries indicates that there could be multiple areas of such potential conflict. Such conflicts could be minimized by detailing out the privacy compliance requirements by various participants and stakeholders in the IBC ecosystem, in terms of purpose and period of processing personal data and to ensure that they are aligned with the broad principles of the DPDP Act. This shall ensure that the processes under the Code are covered under the ground of legitimate use and the applicable exemptions. Such policies may also be drawn from the privacy policies adopted by other market regulators. Further, as a forward-looking measure, businesses may be required to draft their data privacy policies in a manner which creates exceptions for any future insolvencies.

[1] Digital Personal Data Protection Act, 2023 notified in the Official Gazette of 11th August 2023.

[2] Preamble, Digital Personal Data Protection Act, 2023.

[3] *K.S. Puttaswamy v. Union of India*, 2017(10) SC 1.

[4] *Ibid.*

[5] *Ibid.*

[6] *Ibid.*

[7] Acquisti A. et al. (2016), "The Economics of Privacy", 54(2), Journal of Economic Literature 444.

[8] *Ibid.*

[9] *Vikas Sales Corporation v. Commissioner of Commercial Taxes*, AIR 1996 SC 2082.

[10] Hummel, P. et. al (2021), "Own Data? Ethical Reflections on Data Ownership", 34 Philos. Technol, pp. 545–572; Joseph V. and Ambadipudi S., "Exploring Property Rights in Personal Data".

[11] Preamble, Digital Personal Data Protection Act, 2023 provides protection for only digital or intangible data.

[12] Supra Note 9.

[13] Posner R. (1977), "The Right of Privacy", Georgia Law Review 12, 393 (1977).

[14] *Ibid.*

[15] Warren S. and Brandeis L. (1890), "The Right to Privacy", 4 Harvard Law Review, pp. 193-220.

[16] Rotenberg M. (2001), "Fair Information Practices and the Architecture of Privacy (What Larry Doesn't Get)", 1 Stan. Tech. L. Rev., pp. 26-39.

[17] Balganesh S. (2012), "Quasi-Property: Like, But not Quite Property", 160 U. Penn. L. Rev, 1889 "*Quasi-property interests thus involve the use of a relational entitlement mechanism to simulate property's exclusionary framework within limited settings*".

[18] *Ibid.*

[19] Scholz L. (2016), "Privacy as Quasi-Property", 101 IOWA L. REV. 1113.

[20] Supra Note 9.

[21] Supra Note 3.

[22] Preamble, Information Technology Act, 2000.

[23] Section 43A, Information Technology Act, 2023: "*Where a body corporate, possessing, dealing or handling any sensitive personal data or information in a computer resource which it owns, controls or operates, is negligent in implementing and maintaining reasonable security practices and procedures and thereby causes wrongful loss or wrongful gain to any person, such body corporate shall be liable to pay damages by way of compensation to the person so affected.*".

[24] Section 44(2)(a), Digital Personal Data Protection Act, 2023.

[25] Section 72, Information Technology Act, 2000.

[26] *Ibid.*

[27] Rule 3, Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

[28] Rule 2(1)(1), Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

[29] Rules (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

[30] Preamble, Digital Personal Data Protection Act, 2023.

[31] Section 2(t), Digital Personal Data Protection Act, 2023.

[32] Section 3(b), Digital Personal Data Protection Act, 2023.

[33] Section 4, Digital Personal Data Protection Act, 2023; "*(1) A person may process the personal data of a Data Principal only in accordance with the provisions of this Act and for a lawful purpose,— (a) for which the Data Principal has given her consent; or (b) for certain legitimate uses. (2) For the purposes of this section, the expression "lawful purpose" means any purpose which is not expressly forbidden by law*".

[34] Section 6, Digital Personal Data Protection Act, 2023.

[35] Section 2(i), Digital Personal Data Protection Act, 2023.

[36] Section 8, Digital Personal Data Protection Act, 2023.

[37] Section 16, Digital Personal Data Protection Act, 2023.

[38] Section 4, Digital Personal Data Protection Act, 2023.

[39] Section 4(1)(b), Digital Personal Data Protection Act, 2023.

[40] Section 17, Digital Personal Data Protection Act, 2023.

[41] Explanation, Section 17(f), Digital Personal Data Protection Act, 2023.

[42] Section 6(4), Digital Personal Data Protection Act, 2023.

[43] Section 33, Digital Personal Data Protection Act, 2023.

[44] Section 215(2), IBC.

[45] Section 215(3), IBC.

[46] Section 214, IBC.

[47] Section 7(4) and Section 9(3)(d), IBC.

[48] Standing Committee of Finance (2021), "Implementation of Insolvency and Bankruptcy Code-Pitfalls and Solutions", Recommendation 9.

[49] Report of the Insolvency Law Committee, February, 2020, para 4.4.

[50] Report of the Insolvency Law Committee, May, 2022, para 2.10.

[51] Report of the Colloquium on Functioning and Strengthening of the IBC Ecosystem, November, 2022, Recommendation 2.

[52] *Ibid.*, Recommendation 1.

[53] Sections 18(a) and 37, IBC.

[54] Sections 18(f), 242(a) and 35(1)(b), IBC.

[55] Section 196, IBC.

[56] Section 196(1)(h)-(k), IBC.

[57] Section 29(2), IBC.

[58] Regulation 21, IBBI (Insolvency Professionals) Regulations, 2016.

[59] Regulation 13, IBBI (Information Utilities) Regulations, 2017.

[60] Regulation 22, IBBI (Information Utilities) Regulations 2017.

[61] Clause 2.6, Guidelines for Technical Standards for the Performance of Core Services and Other Services under the IBBI (Information Utilities) Regulations, 2017.

[62] Section 29(2), IBC.

[63] SEBI Cyber Security & Cyber Resilience framework for Stock Brokers / Depository Participants, 3 December 2018 Circular No.: SEBI/HO/MIRSD/CIR/PB/2018/147; SEBI Cyber Security and Cyber Resilience framework for Mutual Funds / Asset Management Companies (AMCs), 10 January 2019 SEBI/HO/IMD/DF2/CIR/P/2019/ 12

[64] Cyber Security Framework in Banks, 2 June 2016, RBI/2015-16/418.

[65] Master Direction on Information Technology Framework for the NBFC Sector, 2017.

[66] Master Circular on Customer Service in Banks, 2015.

[67] *Ibid.*

[68] Section 3, The Public Financial Institutions Act 1983; Sections 3 and 29, The Credit Information Companies (Regulation) Act, 2005.

[69] IRDAI Information and Cyber Security Guidelines, 2023; TRAI Recommendations on Privacy, Security and Ownership of Data, 1 September 2020.

[70] Section 17, Digital Personal Data Protection Act, 2023.

[71] Preamble, IBC.

[72] "NCLT raises doubt over confidentiality of liquidation valuation of Videocon", *Economic Times*, June 16, 2021.

[73] Janger E. (2003), "Muddy Property: Generating And Protecting Information Privacy Norms In Bankruptcy", 44 Wm. & Mary L. Rev. 1801.

[74] Section 502, Subtitle A, Title V; "*subject to certain exceptions, prohibits a financial institution from disclosing non-public personal information about a consumer to non-affiliated third parties, unless (i) the institution satisfies various notice and opt-out requirements, and (ii) the consumer has not elected to opt outof the disclosure.*"

[75] Section 363(b)(1), U.S. Bankruptcy Code Section 363(b)(1).

[76] Supra Note 73.

[77] In re Toysmart.com, LLC, No. 00-13995-CJK (Bankr. D. Mass. filed June 9, 2000).

[78] European Union General Data Protection Regulation, 2018.

[79] "Data protection concerns for insolvency practitioners", May 6, 2022, Pinsent Masons.

[80] *Green v. Group Ltd & Ors* [2019] EWHC 954 (Ch) (17 April 2019); *Southern Pacific*

Personal Loans Ltd, Re [2013] EWHC 2485 (Ch) (08 August 2013).

[81] Hauck R. (2019), "Personal Data in Insolvency Proceedings: The Interface between the New General Data Protection Regulation and (German) Insolvency Law", 16 ECFR 724.

[82] Section 2(i), Digital Personal Data Protection Act, 2023: '*means any person who alone or in conjunction with other persons determines the purpose and means of processing of personal data*'.

[83] Report of Bankruptcy Law Reform Committee, 2015, Vol. 1, Para 4.3.7.

[84] Section 4(1)(b), Digital Personal Data Protection Act, 2023.

[85] Section 17(b), Digital Personal Data Protection Act, 2023.

[86] Section 17(f), Digital Personal Data Protection Act, 2023.

[87] Sections 8(5), Digital Personal Data Protection Act, 2023.

[88] Section 6, Digital Personal Data Protection Act, 2023.

[89] Section 13, Digital Personal Data Protection Act, 2023.

[90] Supra Note 58.

[91] Section 17(b), Digital Personal Data Protection Act, 2023.

[92] Section 30(2), IBC: "…(*e) does not contravene any of the provisions of the law for the time being in force (f) conforms to such other requirements as may be specified by the Board.*"

[93] Sections 8(5) and 17 (a), Digital Personal Data Protection Act, 2023.

[94] Section 17(a), Digital Personal Data Protection Act, 2023.

[95] Section 6, Digital Personal Data Protection Act, 2023, "The consent given by the Data Principal shall be free, specific, informed, unconditional and unambiguous with a clear affirmative action, and shall signify an agreement to the processing of her personal data for the specified purpose and be limited to such personal data as is necessary for such specified purpose.

[96] *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, (2020) 8 SCC 531

[97] *M/s. Dishnet Wireless Limited v. Assistant Commissioner of Income Tax (OSD).* W.P.No.34668 of 2018 (Madras HC)

28

Interplay of Insolvency Law and Crypto: Challenges and A Possible Way Forward

- Anita Shah Akella

DEFINING DIGITAL ASSET AND CRYPTOCURRENCY

A 'Digital Asset', according to the International Institute for the Unification of Private Law (UNIDROIT), is an electronic record that can be controlled. In this context, 'control' refers to the sole power to stop others from gaining virtually all of the benefits from the digital asset as well as the capacity to do so. The term 'control' takes on a function that is equivalent to 'possession' of movables. Possession is not a legal idea, but rather a real matter. Furthermore, because a digital asset lacks the physical *situs* component that applies to possession of movables, this functional equivalent to possession solely refers to dominion and power over a digital asset. The surfacing of digital assets has challenged the traditional financial system and the regulatory framework for insolvency proceedings.

Digital assets use blockchain to transfer economic value. Blockchain is not limited to crypto assets and can also store, transfer and record tokens of values. The token is a digital asset personalised by its author, emitted and exchangeable via blockchain and which has all the characteristics of a crypto asset. Cryptocurrency is the decentralized digital money based on blockchain technology and secured through cryptography, offers a myriad of benefits which have directly contributed to its popularity and success. Crypto became popular because of its anonymity, and as an effective alternative for cross-border payments. At present, several variations of crypto such as Bitcoin, Ripple, Litecoin and Dogecoin are traded over dedicated platforms called crypto exchanges.

Nevertheless, the fast-paced growth of crypto, coupled with lack of custody over the asset, and high volatility make it highly susceptible to fluctuations in value and this makes it a high-risk investment. With a global recession setting in and the current environment of rising interest rates, concerns have been raised about the likelihood of insolvency of corporate groups involved in crypto trading.

CATEGORIZATION OF CRYPTO AS ASSETS OR CAPITAL?

Crypto is at its core a cryptographic code and it is difficult to determine whether it should be categorized as an asset, security, capital or something else.[1] Different countries have adopted distinct approaches to this categorisation based on their socio-economic policies. However, it is imperative to determine this fundamental question in the context of insolvency proceedings. The characterisation of crypto as a currency or property can significantly impact its valuation as well as recovery.

In *AA v. Persons Unknown*, the courts of England have held Bitcoins to be 'property' under English law.[2] Due to the broad definition of 'property' under the UK Insolvency Act 1986, it is highly likely that the courts will interpret crypto in a manner so as to bring it within the ambit of the definition.[3] If crypto were not considered to be property, then it would be unclear if it would form part of a debtor's insolvency estate and whether it could be realised and distributed to creditors.[4] It would also be unclear if crypto could be secured to a creditor or held on trust for third parties.[5]

In the Indian context, in *Internet and Mobile Association of India v. Reserve Bank of India*, the Supreme Court had held that crypto is not a legal tender and therefore, cannot be deemed to be a 'currency'.[6] At the same time, the Government of India has stated that gains from the transfer of crypto are taxable under the Income Tax Act of 1961, implying that crypto may be considered property.[7] Further, the definition of 'goods' under the Sale of Goods Act, 1930 and the definition of 'property' under the Transfer of Property Act, 1882 are wide enough to accommodate crypto.[8] Notably, in *Tata Consultancy Services v. State of Andhra Pradesh*, the Supreme Court had also stated that goods may be tangible as well as intangible.[9] This further strengthens the argument for cryptocurrency to be considered 'goods' or 'property'. Recently, a crypto lending company, Celsius Network, which reportedly owes its users around $4.7 billion, went bankrupt. Another crypto company, FTX Group's bankruptcy includes approximately 130 affiliated companies and could trigger contagion in the overall crypto ecosystem. The most recent bankruptcy filing of the lending unit of the crypto firm Genesis on January 20, 2023, serves as an example of the potential cascading effect in the industry.[10]

Such instances have highlighted numerous regulatory challenges that need to be addressed in terms of crypto, especially in terms of the insolvency regime.

ASSET-TRACING AND RECOVERY

Anonymity is a valuable part of crypto's appeal and has been built into its technology and was a major reason behind its popularity. This means that crypto based transactions are not easily identifiable and tracing these assets requires special skills and the engagement and cooperation of blockchain analytics companies.[11]

In addition to this, the crypto industry functions on the idea of 'not your keys, not your coins' which implies that with respect to crypto, as opposed to the general understanding of ownership of property, possession instead of title is the key to controlling the assets.[12] A person who possesses the keys can access and move the assets wherever and whenever they want.

Moreover, crypto can be stored and transferred through 'cold' or 'hot' wallets. Cold wallets allow for crypto to be stored on private addresses and held offline. In such a situation, there is no bank or central authority that can freeze the crypto in the wallet.[13] It is impossible to access a cold wallet without the private key, which is generally only known to the owner. This feature can make it very difficult to access the funds in the wallet when there is a need to secure the company's assets during the insolvency proceedings.[14]

On the other hand, 'hot wallets' allow for the crypto to be held with an exchange which can be contacted by the Liquidator, Trustee or Administrator.[15] However, it must be noted that there is no substantive difference between the technologies behind hot and cold wallets, and that hot wallets can become cold on being disconnected from the network and vice versa.[16]

The usage of cold wallets makes it extremely difficult to recover funds without the owner's cooperation, even if the geographic location of the wallet is known.[17] For instance, QuadrigaCX, one of the most prominent crypto exchanges in Canada, had recently filed for creditor protection under the Companies' Creditors Arrangement Act after the sudden demise of the exchange's CEO.[18] Reportedly, the CEO had held approximately U.S. $144 million in a cold wallet and had not shared the keys with anyone. Consequently, after his death, the company could not access these funds and around 3,63,000 clients lost their crypto.[19]

These several legal and operational issues indicate that it is imperative to devise mechanisms that will improve transparency with respect to transactions through cold wallets. Additionally, alternatives such as wallets with multi-signature addresses that require more than one private key to authorize a transaction, or the use of crypto custodians, could be popularized to improve security and accessibility of funds.[20]

INSOLVENCY IN THE ERA OF CRYPTOS

The advent of digital assets has brought about a paradigm shift in the way financial assets are viewed and managed. Digital assets, which include cryptocurrencies and other blockchain-based assets, offer greater flexibility, transparency, and security than traditional financial instruments. However, the unique nature of digital assets also presents new challenges in terms of insolvency and bankruptcy. Digital assets have disrupted conventional financial landscapes, introducing novel prospects as well as intricacies. One such intricacy is the phenomenon of insolvency within the cryptocurrency arena. As digital assets progressively gain popularity and usage, it is imperative to comprehend the potential implications of insolvency and bankruptcy on crypto assets and their holders.

Digital asset insolvency in India refers to the situation where a digital asset exchange or a custodian holding digital assets becomes insolvent and is unable to fulfill its obligations towards its customers. In India, there is no specific law governing the insolvency of digital assets, and the existing insolvency laws may not be fully equipped to handle the unique characteristics of digital assets. However, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) may apply to digital asset exchanges as it covers 'property' of the insolvent entity, which could include digital assets. In case of insolvency, the customers of the exchange may be treated as 'financial creditors' (FCs) or 'operational creditors' (OCs) under the IBC, depending on the nature of their claims.

The issue of whether a creditor can file a claim in digital currency, such as Bitcoins, if a corporation goes bankrupt and possesses digital assets, emerges. According to French Commercial Code Article L. 622-25, the filing of a claim entails stating the amount of the claim due on the date of the judgement initiating the insolvency proceedings. If the amount of the claim is expressed in a foreign currency, the claim must be converted to euros at the rate in effect on that date. Additionally, Bitcoin is not a currency and cannot be regarded as a foreign currency because it is not a national currency, as stated in Article L. 111-1 of the French Monetary and Financial Code. Therefore, the French insolvency judge would not recognize the lodging of claim in Bitcoins.

The IBC seeks a timely resolution of problems relating to repayment of default. Creditors, the corporate debtor (CD), and debt or a claim or liability for the CD, are the three main variables in an insolvency procedure. When a default occurs, the creditor files an application with the National Company Law Tribunal, the Adjudicating Authority (AA), under section 7 or 8 of the IBC. An FC may submit an application to the AA under section 7 of the Code. Similar to how OC can file an application under section 8 of the Code, so can CD itself under section 10. The AA then appoint an Insolvency Resolution Professional (IRP), subsequently Resolution Professional (RP). The RP takes possession of the debtor's possessions. After that, the RP takes control of the debtor's property and restructures it to resolve the payment default.

According to section 3(10) of the Code, a creditor is any individual to whom a debt is owed. This debt could be operational or financial. According to section 5(21) of the Code, operational debt includes both commodities and services. When a CD has property in digital form and it is all stored in a digital form crypto wallet, the major issue under the IBC is how to restructure the digital property. Property encompasses money, products, real estate, and actionable claims, whether they are domestic or international, according to section 3(27) of IBC. As a result, the AA has the ability to impose restructuring once a default has been proved.

Under section 18(f) of the Code, the IRP may take custody of digital assets while gathering data on the debtor's assets and assuming control over them, whether tangible or intangible. Therefore, regardless of how precisely cryptocurrencies are categorised, they continue to be an asset that is included in the IBC's restructuring procedure.

While managing restructuring operations involving digital assets, Insolvency Professionals (IPs) face various difficulties due to the lack of legislation and identification of these assets. Determining whether the debtor has Bitcoin assets is one of these issues. The Government has revised Schedule III of the Companies Act, 2013, requiring businesses to disclose their digital assets in order to address this difficulty. This change makes it simpler for IPs to determine the existence and placement of the assets.

The RP faces significant difficulties in valuing digital assets. As the bankruptcy processes under the IBC have no special provisions to perform the valuation of the cryptocurrency assets, the value of digital assets could result in legal disputes where parties litigate the right valuation utilising expert witnesses, evidence, and comparisons to analogous assets. Given the volatility of digital assets and the fact that they are frequently not connected to any external fixed prices or scales, figuring out their value will be much more difficult.

Another problem with digital assets' bankruptcy is that if they are kept in offline 'cold wallets', no bank or central authority can send a notice of appointment to transfer or freeze crypto assets to the wallet. Hot wallets, which are often held with an exchange can be questioned by an Administrator, Liquidator, or Trustee if the owner of the wallet forgets the key to their own wallet. Many digital assets are kept in decentralized wallets that are inaccessible to everyone because the key has been lost and cannot be restored. Therefore, it is essential that the IP hires professionals who can assist with security and look to re-key the digital wallet. Due to the fact that digital assets are typically kept in private digital wallets and can only be accessed with a private key, the IP also needs the debtor's full cooperation in order to seize custody of those assets. If a debtor's digital asset is kept in a custodial digital wallet, it may be difficult for the IP to separate it from the assets of other clients of the custodial cryptocurrency wallet provider.

Using distributed ledger technology, the digital assets or cryptocurrencies, are not based in a single state. Due to the precedents that bankrupt cryptocurrency exchanges around the globe have set, Office holders and Trustees now need to apply for enforcement orders in a variety of jurisdictions in order to reclaim their funds. It's also feasible that different jurisdictions' rulings conflict in the absence of uniform cross-border regulation. As an illustration, even though a security may not be valid under English law if it hasn't been registered over crypto assets in England, an Indian Court may nonetheless uphold the security.

The volatile nature of digital asset is also a challenge for IP liquidating a large part of digital asset in one go or in a short time can affect the price of the concerned cryptocurrency.

EVALUATION AND DISTRIBUTION OF DEBT

After all the crypto owned by a company has been identified, recovered and secured, the IP must decide how to value and sell it, but this poses another layer of challenge given the volatility of crypto. The lack of a centralized body overseeing the value of cryptocurrencies is one of the main causes of their volatility.[21] Cryptocurrencies function in a decentralized manner, in contrast to traditional currencies, which are governed by central banks and influenced by economic policy. Their value is largely based on market demand and supply dynamics, which are influenced by a wide range of variables including investor attitudes, regulatory developments, technical improvements, and macroeconomic events.[22]

These elements have the ability to swiftly cause significant price changes in the cryptocurrency market. For instance, positive news or endorsements from well-known people on social media or otherwise, might increase interest in a certain cryptocurrency and raise its price. On the other hand, unfavorable occurrences like security lapses, regulatory crackdowns, or accusations of market manipulation can trigger panic selling and lead to large price drops. Due to this, the value of cryptocurrencies can fluctuate drastically and frequently within a few minutes.

This volatility makes it extremely difficult to calculate payment amounts in cryptocurrencies. Even if a payment is agreed upon and is valued at a certain amount in a particular cryptocurrency, it is possible that by the time the payment is completed and distributed, the real value of that coin may have drastically changed. This could result in discrepancies between the anticipated and real values of the payment received, creating potential complications and dissatisfaction for both parties involved.

Furthermore, if there is a decline in the value of crypto during the proceedings, it may raise a question regarding whether the crypto should be held till its value increases or if it should be sold immediately.[23] Relevantly, during the insolvency proceedings of Mt. Gox, the Trustee had sold only a portion of the estate's Bitcoins after waiting for four years.[24] Furthermore, even if the IP decides to sell the crypto, there may be a limited market for specific kinds of non-fungible tokens and crypto that is not traded on big exchanges.[25] This may make it difficult to sell the crypto at a feasible rate within a reasonable period of time.

In the US, the creditors in bankruptcy claims are usually paid in US dollars, as measured on the date of the bankruptcy filing.[26] However, in the case of an insolvency involving crypto, if the valuation is done at the stage of the filing of the claim, then there is a high probability that such valuation will witness some appreciation or depression during the insolvency proceedings itself.[27] Foreseeably, some creditors may want the crypto to be valued and frozen at the time of filing so that they are not affected adversely in the event of any depreciation in the value of the crypto. However, in the case of appreciation, some of the creditors may not want to cash out, so as to avoid tax implications.

To counter the booms and busts characteristic of the crypto market, the IP may use crypto brokerage services or over-the-counter services to realize significantly valuable crypto.[28] Another strategy could be to link the payment amount to a stablecoin, a kind of cryptocurrency intended to retain a value by being linked to a fiat currency or a basket of assets, in order to keep it relatively stable.[29] The payment amount can be protected against the volatility of other cryptocurrencies by using a stablecoin as a reference, leading to increased stability and predictability.

Additionally, organizations should think about putting in place systems that automatically determine payment amounts depending on current exchange rates at the time of distribution.[30] This would make it easier to account for price changes and guarantee that the intended value of the payment is maintained regardless of how much the chosen cryptocurrency changes in value.

IMPLICATIONS FOR CROSS-BORDER INSOLVENCY

Crypto runs on distributed ledger technology and is not geographically located in any one jurisdiction.[31] Thus, cross-border cooperation and coordination is important in crypto related insolvency matters. Due to the technology behind crypto, it will be possible for multiple courts to simultaneously have jurisdiction with respect to a distressed debtor.[32] The English Courts have claimed that crypto should be considered to be located wherever the owner of the crypto is domiciled.[33] However, it is foreseeable that other countries may disagree and have their own ideas regarding the manner in which the jurisdiction must be determined.

Even if the question of jurisdiction is settled, the enforcement of an order may still require cross-border assistance.[34] It is possible that the relevant stakeholders in an insolvency matter may all be present in different jurisdictions. In such circumstances, it would be necessary for IPs, Courts and other authorities to work together to ensure that the insolvency process progresses smoothly.

It has been previously argued that the absence of a coordinated response in such cases inspires a 'race to the bottom' with authorities from different countries scrambling to obtain and secure the assets.[35] This harms the collective interest of all stakeholders. Such a situation also undermines the very objective of insolvency laws and hinders the attempts of courts and IPs to find the best solutions to the debtor's economic problems.[36]

CONCLUSION

The above analysis of issues in terms of regulation of crypto insolvencies indicates that the legal regime in the same is globally unsettled. These issues include treatment of crypto as property, valuation of the currency, gaining control over the assets and cross-border jurisdiction concerns given it is delocalised in nature. While in UK and US, there has been some nascent development of jurisprudence in order to address issues arising of insolvencies involving crypto assets; however, given the highly deregulated and decentralized nature of the currency, the position is largely unsettled. Given the ongoing slowdown in markets, global legal regimes including India need to gear towards formulating a framework for crypto insolvencies in order to avoid a cascading effect on global markets and to protect the stakeholders.

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Future - Proofing the IBC - Insolvency of a Data Centre or a Cloud Service Provider

- Devendra Mehta

INTRODUCTION

Cloud computing is growing at a phenomenal pace across the globe. As per Statista, the statistics portal for market data, around 60% of the worldwide corporate data in 2022 was stored in the cloud. COVID-19 pandemic gave an impetus to the adoption of cloud as the corporates with on-site servers lagged to adapt to remote work. Pandemic upended a lot of established practices which may or may not continue in the post-pandemic era; the current tug-of-war between employees and employers on the concept of work-from-home being one such aspect. Nevertheless, for the moment, cloud computing continues to grow. In fact, the backing of giant corporates and the convenience of cloud have lulled our senses to any impending risks including that of insolvency.[1] However, with the volume of data residing in the Cloud and the Data Centres (DCs), an insolvency of a large service provider can have massive disruptive effects on the economy. An example pertaining to the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) will illustrate the aforesaid. Regulation 4C of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) requires an Interim Resolution Professional to open an email account for all correspondence. This email account has to be handed over to the Resolution Professional (RP) in case of a replacement and to the Liquidator thereafter in case a resolution is not achieved. The common market practice is to open a 'Gmail' account to comply with the CIRP Regulations. Imagine a scenario where Gmail is facing a technical issue that continues for a few days; the insolvency resolution process of most of the corporates will come to a standstill. What is true of IBC, holds true for the corporates and the Government, though at an infinitely larger scale. Thus, complacency *vis-à-vis* insolvency of Cloud Service Providers (CSPs) and DCs may come to haunt us one day; the event of insolvency will have a magnitude much larger than a few days of technical glitch. The problem may get compounded as the Government is actively promoting these sectors.

A December 2022 press release of the Ministry of Information and Broadcasting, Government of India states that India would be a Cloud Computing and Data Centre Hub. DCs were included in the harmonized list of infrastructure in October, 2022.[2] Presently, India has around 800 MW installed power capacity for DCs and is projected to grow to 1700MW by March 2025; developers have a pipeline of over 3000MW to be delivered over next 10 years requiring a capex of ~USD 23Bn.[3] There are about 20 Cloud Service Providers empanelled with Ministry of Electronics and Information Technology.[4] (MeitY)

However, DC owners and a CSP are not necessarily the same corporate/ legal entity. The Hyperscale[5] Data Centres are owned by the CSPs; the Co-location Data Centre rent out space to CSPs and to the companies who keep their servers and networking equipment at a third-party location; and the Captive Data Centres usually belong to the Governments / public sector.

It may be argued that a fast-growing sunrise sector is not an insolvency candidate. However, growth attracts multiple players, and it is inevitable that some will fail; white swan events are a given. Distress may arise due to change in macro-economic situation;[6] customers renegotiating contracts with service providers,[7] unavailability of enough land and electricity,[8] local opposition,[9] climate protests,[10] excessive leverage and inadequate cash-flows as described in examples below, regulatory changes including sustainability directives or licensing requirements for imports, modification of tax laws, investigation from anti-competition authorities,[11] geopolitical issues,[12] cloud proposition turning expensive or technological obsolescence,[13] and any other black swan event.

Also, it is likely that big technology companies i.e., the Hyperscale CSPs may not rent DCs in future, but build their own. As building data centres is expensive, the highly indebted Co-location DCs in a rising interest rates environment may undergo financial distress.

Thus, numerous factors can lead to insolvency. Insolvency can take three forms: insolvency of the DC, insolvency of the CSP or insolvency of both the DC and CSP. Before the peculiarities of such insolvencies and the issues that may need to be addressed, are ventured into, the article first examines some real-life examples of the aforesaid categories and the resultant consequences.

INSOLVENT DATA CENTRE

Insolvency of a DC can result into huge costs for its customers; both financial and non-financial. A case in the point is the bankruptcy of DC operator Cyxtera Technologies Inc., a provider of Co-location services in June, 2023. Dell, which was a customer of Cyxtera was forced to orchestrate a complex and costly migration to a new DC. Furthermore, due to migration, Dell expected to incur additional costs of USD 75M for procurement, certifications and breach of its customer contracts.[14] An insolvency of a DC in India of a similar scale can thus wreak havoc for some of the corporates.

Cyxtera Technologies Inc.

Cyxtera was a medium sized corporate. It had agreed to go public through a merger with a blank-check firm, in a deal valuing the entity at $3.4 billion. If it would have been an Indian company, it would have been in the list of Top 200 corporates in terms of market capitalisation. India had a total DC capacity of 800MW as of December, 2022.[15] In comparison Cyxtera singularly had 245 MW of capacity, was operating at more than 60 locations when it filed for U.S. bankruptcy protection, two years after the company went public. The company cited financial difficulties and funding shortage as the reason. The company's operations were spread across 30 markets, though its subsidiaries in Germany, Singapore, and the United Kingdom were not included in the US court-supervised process.[16] The company had a net loss of USD 355M in 2022. The bankruptcy had a ricocheting effect on the Digital Core REIT of which Cyxtera was a tenant. The peculiarities of Real Estate Investment Trust (REIT) are discussed later in the paper.

INSOLVENT CLOUD SERVICE PROVIDERS

In the first instance the insolvency of CSPs seem to be beyond the realm of possibilities as the names that first come to mind are those of the prominent Hyperscale CSPs. However, in their heydays the possibility of distress was unthinkable for many a corporates like Kodak, Nokia, Blackberry etc. Moreover, not all CSPs are Hyperscalers.

Insolvency of CSPs may be consequential for India. The MeitY empanelled CSPs fall in three categories; Public Cloud (PC), Virtual Public Cloud (VPC), and Government Community Cloud (GCC). None of the Hyperscalers i.e., Amazon, Google, Microsoft, Oracle etc. are empanelled as GCC. GCC is meant for departments where dedicated security is required, including that of Government, along with an isolated environment. Thus, though the security risk may have been addressed by a separate class of GCC providers, no *modus-operandi* for insolvency risks is provided. The only reference to insolvency is provided in the model Master Services Agreement of MeitY wherein it states that the purchaser of services may terminate the agreement if the service provider reports an apprehension of bankruptcy.

Moreover, a regulated entity may use any of the CSPs, irrespective of size, especially for data localization requirements of various regulators, an aspect discussed later in the paper. Insolvency of such a CSP may lead to systemic issues.

Also, the pricing tactics of Hyperscalers will lead to margin pressure on all other CSPs. In some instances, this may result in paucity of customers for such CSPs, further aggravating the situation. A recent bankruptcy, that of American Virtual Cloud Technologies Inc. arose as it was not able to garner the planned customer base.

American Virtual Cloud Technologies Inc.

American Virtual Cloud Technologies, Inc. and two of its subsidiaries filed for Chapter 11 protection in January, 2023. The need for Chapter 11 protection arose primarily by an inability to operate profitably as a going concern and a waning liquidity position. The company had a cloud-based, real-time communications platform, offering proprietary unified communications as a service, communications platform as a service, Microsoft Teams Direct Routing as a Service, and SIP Trunking as a Service capabilities. It supported the digital and cloud transformation of mid-market and enterprise customers across virtually any device, on virtually any network, in virtually any location.[17] Moreover, though the company managed to have strategic partnerships with AT&T, IBM/ Kyndryl, and Etisalat it was unable to attract the customer base it needed.

INSOLVENT DATA CENTRE AND CLOUD SERVICE PROVIDER

The pertinent factors described above for insolvency of DCs and CSPs are the same when the entity is a combination of a DC and a CSP. However, even though a framework for insolvency of DCs and CSPs is to evolve, a quick resolution and availability of interim finance, as in the case of Sungard Availability Services LP, can minimize disruptions for customers.

Also, some of the factors enumerated above were listed by the CEO of Sungard at the time it filed for bankruptcy; 'challenges in capital structure, COVID-19, macroeconomic trends, delayed customer spending decisions, insourcing, reduction in IT spending, energy inflation and reduction in demand for certain services'.[18]

Sungard Availability Services LP

Sungard Availability Services LP filed for Chapter 11 bankruptcy in April, 2022 with simultaneous proceedings in Canada and UK: three years after settling a previous Chapter 11 filing as it continued to be overleveraged. Although the company eliminated more than $800 million in debt in its last Chapter 11 filing, the company still had $424 million of debt on its books, which it could not service.[19] Incidentally, the company also had operations in India though they were not affected by bankruptcy.

11:11, a managed infrastructure solutions provider focused on cloud, security, and connectivity solutions, acquired in early November, 2022, Sungard AS' Cloud and Managed Services (CMS) business, consulting business, and four DCs. Similarly, 365, a leading provider of network-centric colocation solutions, too acquired in early November, 2022, a majority of Sungard AS' U.S.-based Co-location DCs and Network Services business[20]. On the other side of Atlantic managed services company Redcentric Solutions (RSL) bought three DCs of the UK branch of Sungard in June 2022.[21]

UKCloud

The example of UKCloud should serve as an example of a cautionary tale for India. MeitY has floated a tender in last quarter of calendar year 2022 for selection of a Program Management Agency for setting up 200MW hyperscale DCs. This National Government Cloud (NGC) was to firewall all data generated by various arms of Government including sensitive defence data.[22]

UKCloud was a British public-sector cloud provider, established in 2011, and boasted customers such as central and local governments, the police, the Ministry of Defence, the National Health Services, Home Office, Driver and Vehicle Licensing Agency, and Ministry of Justice, Genomics England, the University of Manchester, and more was placed into liquidation in October, 2022. Also, UKCloud was a prominent supplier to government procurement frameworks such as G-Cloud and the government's Digital Marketplace.[23] However, the British Government did not have the budgetary resources to support UKCloud.

The move to liquidate UKCloud drew a lot of criticism. 'UKCloud do an awful lot of the heavy work at proof-of-concept stage in UK government, only to have the actual contract for delivery – which can run into hundreds of millions of pounds – wrested away and given to a hyperscale cloud provider'.[24] 'It's hard to see what is gained by actively undermining a successful British company in this way';[25] a sentiment shared by several within UKCloud's 300-strong partner and reseller community. 'If 90% of your customer base is public sector, then the Cabinet Office is effectively making it a foregone conclusion by forcing all of their paying clients to leave'.[26]

As mentioned above Meity is in the process of setting up a NGC which is going to be repository of sensitive information akin to the UKCloud. Also,

> MeitY has recently awarded a contract to restructure National Informatics Centre (NIC) as well as Digital India Corporation (DIC). NIC provides the government with essential digital services such as email, network infrastructure, data centres, software applications, cloud services, chat platforms, security measures, and more. DIC has played a key role in developing important digital services such as Digilocker that allow access to e-versions of documents, and Government e-Marketplace (GeM), the centralised platform for public procurement. The real risk lies in the private sector potentially prying strategic control from the government's hands.[27]

Thus, it would be good for us to imbibe the lessons of UKCloud. The article now examines the peculiarities that will arise from the insolvency of a DC/CSP.

EFFECT OF OTHER LAWS ON INSOLVENCY OF DATA CENTRE AND / OR CLOUD SERVICE PROVIDERS

IBC had been subjected to numerous legal challenges since its enactment vis-à-vis its standing versus other acts and statues: State Statues, Prevention of Money Laundering Act, State Tax Laws, Securities and Exchange Board of India Act, Prevention of Corruption Act, Income

Tax Act, Customs Act etc. IBC has triumphed other laws in all of the aforesaid instances as it was a latter law with a non-obstante clause under section 238. However, this may not hold true going forward as new laws get enacted with their own non-obstante clauses.

The draft Data Centre Policy 2020[28] (DCP) stipulates that DCs should be declared as an Essential Service under The Essential Services Maintenance Act, 1968 (ESMA). The rationale provided is that the inclusion of DC under the ESMA will enable seamless continuity of services even during times of calamities or crisis. The Telecom Regulatory Authority of India (TRAI) too endorses the aforesaid viewpoint.[29] ESMA primarily deals with striking employees, is a central legislation, though many states have enacted their own versions of ESMA.

If enacted in the present form, the interaction of ESMA with IBC will give rise to a conflict. Both the legislations have a non-obstante clause; though IBC is the latter legislation, the notification for DCs falling under ESMA will be issued post commencement of IBC. Which of the two shall prevail?

One may contend that ESMA may not conflict with IBC as ESMA is geared towards ensuring employees perform their respective tasks. However, in most cases, admission to an insolvency is a lagging indicator of stress. Months before a corporate debtor (CD) is admitted, it would have started delaying payments to creditors, utilities, statutory authorities, employees etc. In such scenario employees are exploring opportunities elsewhere. Thus, if ESMA is enforced, will a managerial person be allowed to resign and leave, if the committee of creditors (CoC) is agreeable to such an act? What happens if no resolution plan is received, and the National Company Law Tribunal (NCLT) orders a liquidation under section 33 of IBC? Can ESMA still mandate employees to continue working? Section 33(7) states that *'the order for liquidation 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'*.

The TRAI paper further recommends that DCs shall be included in the list of exemptions from inspections under provisions of the Factories Act, 1948, Shops and Commercial Establishment Acts, other labour laws, and laws on wages. Some states have already granted full exemption from the provisions of Factories Act, 1948, labour laws etc. In such a scenario, will the workmen dues of twenty-four months and dues of employees other than workmen for twelve months be subjected to waterfall under section 53 of IBC?

Another law, that will influence insolvency of DCs/CSPs, is the Digital Personal Data Protection Act, 2023 (DPDPA). DPDPA defines Data Principal as an individual to whom the personal data relates and where such individual is a child includes the parents or lawful guardian of such a child. Consent of Data Principal is required to process his/her personal data for the specified purpose. However, the Act under section 4 states that personal data of a Data Principal can be processed for lawful purposes (without consent) and certain legitimate uses. Furthermore, under section 7 of DPDPA, certain legitimate uses means, amongst others, that personal data of Data Principal can be Processed[30] for compliance with any judgement or decree or order issued under any law for the time being in force in India, or any judgement or order relating to claims of a contractual or civil nature under any law for the time being in force outside India.

This brings up a question. Can the Insolvency Professional (IP), who may be in the shoes of Data Fiduciary or Data Processor, in case of an insolvency, sell data and more so share data of a third party for recovery of debt? Regulation 29 of CIRP Regulations deals with sale of assets outside the ordinary course of business:

> The Resolution Professional may sell unencumbered asset(s) of the corporate debtor, if he is of the opinion that such a sale is necessary for a better realisation of value under the facts and circumstances of the case: Provided that the book value of all assets sold during corporate insolvency resolution process period in aggregate under this sub-regulation shall not exceed 10% of the total claims admitted by the Interim Resolution Professional.

The data *per-se* will not have any recorded book value.

Furthermore, section 14(1)(d) of IBC puts a moratorium prohibiting, *'the recovery of any property*[31] *by an owner or lessor where such property is occupied by or in the possession of the corporate debtor'*. This clause is intended to keep a going concern. The owner is compensated for aforesaid harm by granting a priority under Regulation 31(b) of CIRP Regulations; *'Insolvency resolution process costs under section 5(13)(e) of IBC shall mean amounts due to a person whose rights are prejudicially affected on account of the moratorium imposed under section 14(1)(d) of IBC'*. Additionally, section 18 mandates RP to take control and custody of CD's assets. However, the explanation to the section excludes 'assets owned by a third party in possession of CD held under trust or other contractual arrangement including bailment'. Thus, can a RP share & disclose data for recovery of debt under DPDP which does not even belong to the CD?

Also, section 36(4) of IBC buttresses the argument of not using third party assets. The said section defines assets that will not form part of the liquidation estate assets and shall not be used for recovery in the liquidation, i.e., *'assets owned by a third party which are in possession of the corporate debtor, including assets held in trust for any third party'*. Thus, the intersection of the aforesaid two acts may create a conflict. Furthermore, DPDPA under section 38(2) states that 'in the event of any conflict between a provision of this Act and a provision of any other law for the time being in force, the provision of this Act shall prevail to the extent of such conflict'.

A few of the IBC procedures will require additional steps by the IP due to DPDPA. Section 29A lists out criterion wherein a person is not eligible to submit a resolution plan. A number of stipulated conditions pertain to individuals, who will be a Data Principal under DPDPA and the information about such individuals may not be available in public domain. Similarly, Regulation 35A of CIRP Regulations requires the RP to determine whether the CD has been subjected to any PUFE[32] transactions. In both of the aforesaid situations the IP will have to seek 'specific-order' from NCLT, due to the requirements of DPDPA, to access the data of specific individuals, to form an opinion.

UNIQUE ASPECTS OF INSOLVENCY OF CLOUD SERVICE PROVIDERS AND DATA CENTRES

Aspects pertaining to moratorium under section 14

As described above a moratorium is imposed from the insolvency commencement date. The moratorium under section 14(1)(d) prohibits recovery of any property by an owner or lessor where such property is occupied by or in the possession of the CD.

However, what happens when the CD has protection of moratorium but does not have the cash to provide services? 2e2, the datacentre service provider and systems integrator that went into administration in 2013 asked its customers for nearly £1M in funding if they wanted uninterrupted services and access to their datacentre facilities. The enterprise-level users were asked to pay most of the datacentre costs and smaller businesses are being asked to pay £4,000 plus VAT.[33] In such instances, if the CD is unable to raise interim finance will the CoC provide for such finance, or the debtor must fall back on customers? Also, will such customer finance be treated as interim finance? This is because section 5(15) of IBC defines interim finance as any financial debt raised by the RP during the insolvency resolution process period. Further, financial debt under section 5(8) of IBC includes any amount raised having the commercial effect of borrowing.

Another debate will ensue on the definition of essential goods and services under section 14(2) of IBC; the supply of these shall not be terminated or suspended or interrupted during moratorium period. Regulation 32 of CIRP Regulations further clarifies that essential goods shall mean electricity, water, telecommunication services and information technology services to the extent these are not a direct input to the output produced or supplied by the CD. The regulation also gives an example, that water supplied to a CD will be essential supplies for drinking and sanitation purposes, and not for generation of hydroelectricity. In case of a DC, electricity, water, telecommunication services, and information technology services may be classified as 'direct input to the output produced'. It is highly likely that the aforesaid will be classified as critical goods or services to protect the value of CD. However, critical goods or services require payment for the period post the insolvency commencement date and the debtor should have funds available to that extent.

Undervalued transactions under section 45

The first requirement in determining an undervalued transactions is its valuation. This is easier said than done; an OECD report states that though data is called the new oil putting precise numbers on its costs and benefits remain elusive. The report states that data have a specific combination of economic characteristics that distinguish them from other production inputs and have implications for the measurement of their value. Information on prices and volumes might not adequately reflect users' valuation of their data. Due to the specific characteristics of data, data markets are difficult to establish and sustain. Indeed, significant amounts of data collected by private entities are not traded in markets. As most data are not traded, only a small portion of their value can be measured based on market statistics.[34]

Moreover, the three commonly used methods[35] to value data will not be appropriate as they primarily deal with valuation of data basis their existing use. However, the valuation of data depends not only on its current use but also on the alternate uses.

The bankruptcy of Caesars Entertainment Corp in 2015 gives us a glimpse of value that resides in data. The most valuable asset in the bitter bankruptcy feud wasn't the opulent Roman themed resort at the heart of the Las Vegas strip but the big-data customer royalty programme valued by creditors at USD 1 billion. *'Creditors groups alleged that transaction involving the loyalty programme were insider deals, sponsored by Caesars parent entity and private equity sponsors, Apollo Global Management LLC and TPG Capital'*.[36] Thus, creditors were considering the transaction as undervalued and preferential. Thereafter, the cofounder of Apollo Global Management, resigned from the board of Caesars after an investigation found that he had led a deal that was undervalued and short-changed the now bankrupt unit.[37]

An example from the COVID-19 period too exhibits the alternate-use valuation of data; not of bankruptcy but of a restructuring under distress. United Airlines and American Airlines secured multibillion dollar loans by collateralizing MileagePlus and AAdvantage loyalty programs. United's customer data was valued at USD 20 Bn whereas its market cap was about USD 9Bn. American's data was valued in a range of USD 19.5 Bn to USD 31.5Bn whereas its market cap was less than USD 8Bn.[38]

Finally, section 45 requires that in case there is an undervalued transaction it should be made void and reversed. Though, the monetary value may accrue back to CD how likely it is that the data will revert? The data may have taken myriad forms, may have been on-sold, or may have been fed to train an artificial intelligence model and thus may no longer be an exclusive proprietary asset of the CD.

Class of creditors

As described above the data has a monetary value, though the exact determination of that value is subjective. In case the data has been on-sold or the data-owners are not able to remove their data and change the service provider due to the insolvency moratorium, shouldn't the data owners be treated as some form of 'class of creditors' to the extent of their loss in value? The value may be determined basis any of the valuation methods or may be determined as defined in the contract; usually, an overall cap linked to revenue under that contract for the CSP. Also, how different are the aforesaid data owners from the folks who use safe-deposit lockers in banks for their valuables or the fixed deposit holders in an insolvency apart from the fact that the data owners do not earn interest.

Practicality of implementation of insolvency related clauses

It is likely that *ipso facto* clauses will be built into contracts between the customer and the DC/CSP; the model contract of MeitY has a clause on similar lines.

Hon'ble Supreme Court in *Gujarat Urja Vikas Nigam Limited*[39] had stated that barring the circumstance of 'death of a CD' the *ipso facto* clauses will be allowed to function.

> Given that the terms used in Section 60(5)(c) are of wide import, as recognized in a consistent line of authority, we hold that the NCLT was empowered to restrain the appellant from terminating the PPA. However, our decision is premised upon a recognition of the centrality of the PPA in the present case to the success of the CIRP, in the factual matrix of this case, since it is the sole contract for the sale of electricity which was entered into by the Corporate Debtor. In doing so, we reiterate that the NCLT would have been empowered to set aside the termination of the PPA in this case because the termination took place solely on the ground of insolvency. The jurisdiction of the NCLT under Section 60(5)(c) of the IBC cannot be invoked in matters where a termination may take place on grounds unrelated to the insolvency of the corporate debtor. Even more crucially, it cannot even be invoked in the event of a legitimate termination of a contract based on an *ipso facto* clause like Article 9.2.1(e) herein, if such termination will not have the effect of making certain the death of the corporate debtor. As such, in all future cases, NCLT would have to be wary of setting aside valid contractual terminations

which would merely dilute the value of the corporate debtor, and not push it to its corporate death by virtue of it being the corporate debtor's sole contract (as was the case in this matters unique factual matrix).

Nevertheless, in case of an insolvency of DC or CSP, the applicability of such *ipso facto* clauses may come in question and be subjected to litigation.

Reserve Bank of India (RBI) Directions[40] on outsourcing of information technology services mandate that in order to mitigate the risk of unexpected termination of the outsourcing agreement or insolvency / liquidation of the service provider, regulated entities (RE) shall retain an appropriate level of control over their IT-outsourcing arrangement along with right to intervene, with appropriate measures to continue its business operations. Further, it shall be ensured that availability of records to the RE and the RBI will not be affected even in case of liquidation of the service provider. Similarly, Securities and Exchange Board of India[41] (SEBI) mandates that an agreement/contract made by an entity regulated by SEBI, shall include a terms/provisions/clauses in its outsourcing agreement, specifying the resolution process for events of default, insolvency, etc. and indemnities, remedies, and recourse available to the respective parties.

However, both RBI and SEBI directions do not delve into the details of actions to be taken in case of an insolvency.

Treatment of subsidized assets

Several state governments are giving a host of subsidies to set-up DCs: land at a concessional rate, capital subsidy in building and infrastructure, rebate on building fee etc. How will such subsidies be treated in case the successful resolution applicant wants to use the facility for purpose other than a DC; for example, will the land be valued at full rate and the state government have a right to the differential amount as their claim?

Insolvency is not applicable to REITs

Globally, several DCs are part of a REIT i.e., legal form of a trust; Cyxtera described above. India will not be an exception to this trend. Global REITs like Digital Realty, Equinix, and Iron Mountain, have invested in India. Moreover, private equity investors who are the largest investors in DCs may also choose to create a REIT. Alternate Investment Funds too can be incorporated in India in the form of a trust, amongst other options.

However, trusts suffer from one drawback i.e., insolvency cannot be instituted against them; section 2 of IBC which specifies against whom insolvency can be filed does not include trusts.

OPERATIONAL ASPECTS TO CONSIDER

Access to data in required format

In case of a potential insolvency, while data could be accessed, it may not be in a format that is usable to customers. Lack of operational transparency within the cloud may result in providers holding and processing data strictly not in accordance with customers' needs. Under the layers of abstraction, cloud providers may or may not decide to change the format of the data or store it in the way they seem fit for their infrastructure or for their platform.[42]

Time required to retrieve data

Nirvanix, the US-based cloud storage provider gave customers two weeks' notice before it was to shut down when it filed for Chapter 11 bankruptcy protection.[43] Such a situation brings us to one of the most significant challenges in cloud storage; the difficulty in moving large amounts of data from a cloud. While bandwidth has increased significantly over the years, even over large network links it could take days or even weeks to retrieve terabytes or petabytes of data from a cloud. For example, on a 1 Gbps link, it would take close to 13 days to retrieve 150 TB of data from a cloud storage service over a WAN link.[44] The situation would aggravate as all the customers will be trying to pull out data from the 'pipes' at the same time. Customers thus need to plan methods of data retrieval in the event their cloud service provider goes bankrupt.

MITIGATION MEASURES

IBC was drafted at a time when DCs and cloud computing were not as prevalent as they are today. The financial architecture of the world has changed since then. Cloud computing has become the norm; DC and/or CSP may have data of RBI regulated entities, SEBI regulated entities and Insurance Regulatory and Development Authority of India (IRDAI) regulated entities. In addition, all the adjacent 'techs' i.e., fintech, insurtech etc. store their data in cloud. Insolvency thus can create disruption in the larger financial ecosystem.

Also, according to a BIS report,[45] *'financial institutions that were using on-premises technological infrastructure at the end of 2020 had plans to switch, on average, 40% of their business operations to public cloud during 2021'*. It is highly likely, that in India too, this trend will exacerbate in the years to come.

To mitigate such a situation a modus-operandi equivalence of section 227 of IBC may be envisaged; the Central Government in consultation with 'appropriate regulator' (to be constituted) notify DCs or CSPs for the purpose of insolvency. Admittedly, the law will not be applicable to DCs and CSPs outside the jurisdiction of Indian authorities, nevertheless, due to data-localization[46] requirements, a segment of the important data will be covered.

Vis-à-vis DCs and CSPs not under Indian jurisdiction, subjecting such asset class to rules of cross-border insolvency may be explored; this may offer minor benefits, as other jurisdictions too would be grappling with aspects of insolvency discussed in this paper.

It is over three years since the report on cross border insolvency as well as the rules and regulations therein have been released. However, for some strategic reasons the legislation has been deferred. Though, a delay in implementation is detrimental to creditors[47] but a measured sectoral approach for implementing cross-border insolvency, in this case, DCs and CSPs can help test the waters. This will be an obverse mirroring of the recommendations in the cross-border insolvency report; herein a sector is expressly included whereas in the report some sectors were being excluded.

The only other way to mitigate the risk of insolvency is by usage of more than one CSP.

CONCLUSION

Insolvency law in India is evolving, and Insolvency and Bankruptcy Board of India and the legislature had been proactive to iron out any deficiencies. Recent amendment to section 14 of IBC wherein an exception was carved out for a CD who has entered into transactions, arrangements or agreements, for the Production Sharing Contracts, Revenue Sharing Contracts, Exploration Licenses and Mining Leases made under the Oilfields (Regulation and Development) Act, 1948 (53 of 1948) is a case in point.

Similarly, the law around DCs and CSPs is evolving.

> There's a vacuum in terms of rules, norms and agreements that govern digital trade. Several models are vying for influence. China promotes an approach rooted in sovereignty and security. Several data protection laws, including the Cybersecurity Law, the Data Security Law, and the Personal Information Protection Law form the core of a system based on control over and access to data through localisation requirements. The European Union has made privacy central to its approach, through its GDPR legislation. By contrast, America largely puts commerce first.[48]

Jurisprudence at the moment is scant. Section 363(b)(1) of the US Bankruptcy Code provides that a company can sell its customers data (personally identifiable information about individuals) if its privacy policy unambiguously permits such a sale. However, if the privacy policy does not so permit, a consumer privacy ombudsman has to be appointed who after notice and hearing may approve such a sale after giving due consideration to facts, circumstances and conditions. Though, not pertaining to a DC or a CSP, the guidelines for sale of data in US bankruptcy, were laid down in the case of *Federal Trade Commission v. Toysmart.com*. Toysmart was a popular online retailer who collected customer information, and had a privacy policy not to share customers information with outside parties. Toysmart attempted to sell customer data in bankruptcy. Federal Trade Commission sued to stop the same. The resultant settlement has been the template for sale of personal identifiable information. The conditions were '(a) customer information was sold as part of a package with other assets, (b) the buyer was in same line of business, (c) buyer agreed to Toysmart's privacy policy and (d)the buyer took affirmative consent from Toysmart's customers'.[49]

DPDPA, though not explicitly addressing insolvency, has provided a carve out under section 17(e) by allowing processing of data if required for a scheme of compromise or arrangement or merger or amalgamation of two or more companies or a reconstruction by way of demerger or otherwise of a company, or transfer of undertaking of one or more company to another company, or involving division of one or more companies, approved by a court or tribunal or other authority competent to do so by any law for the time being in force.

In such a fluid scenario, India can establish a precedence to establish a soft law that cater to DC and CSP insolvencies after public discussion and deliberation amongst experts. The law should cover modalities of interaction with other data laws, structures to which insolvency law will be applicable, aspects of moratorium, methods of valuation, configuration of class of creditors, determination of undervalued transactions, methodology to evaluate resolution plan in case of a proposed alternate usage of assets and the operational aspects.

[1] In this paper the words insolvency and bankruptcy have been used interchangeably.

[2] Ministry of Finance, Department of Economic Affairs, Policy and Planning Unit, The Gazette of India, CG-DL-E-11102022-239561, No 262, New Delhi, Tuesday, October 11, 2022.

[3] Avendus, Data Centres Powering Digital India, May, 2023, p. 3.

[4] Ministry of Electronics and Information Technology, GI Cloud (Meghraj), Audit Status of Cloud Service Providers.

[5] Hyperscale means ability to rapidly scale-up by adding resources i.e., servers and storage. Major Hyperscalers are AWS, Microsoft Azure, Google Cloud and Meta Platform.

[6] Lin B. (2023), "Companies look to pay tech vendors based on business outcomes not usage", The Wall Street Journal, July 5; *"Recent interest in outcome-based pricing—which has been around for decades but not gained widespread traction in technology—is being driven by tighter technology budgets and customer pushback against big cloud-computing charges, analysts say. Most cloud providers charge customers based on the amount of computing power they use, on an as-needed basis, but that can lead to huge, unexpected cloud bills when usage surges".*

[7] Roy S. and Bhalla T. (2023), "How start-ups are cutting cloud costs, renegotiating deals with service providers", *The Economic Times*, March 27.

[8] Miller R. (2023), "After a Record 2022, Limits on Land and Power May Slow Data Center Growth in 2023", Data Center Frontier, February 10; *"In many markets developers will need to work much harder at securing land well in advance (3 years) of needing it and should pursue cover land plays while waiting for utilities to get the power to the site".*

[9] Lehuedé S., (2022), "Big Tech's New Headache: Data Centre Activism Flourishes Across the World", LSE, November 2; *"Intense water usage in Cerrillos, Chile; Data centres in Ireland forecast to use over one quarter of the country's electricity supply by 2028; Agriculture protection in Netherlands".*

[10] Cappella N., (2023), "Data Centre protests are on rise but are they effective?", Techerati, Apr 20; *"Netherlands: Activists vs. Microsoft; Northern Virginia: Citizens for Fauquier County vs. Amazon; East London: Campaign to Protect Rural England vs. Digital Reef."*

[11] Clark S., (2023), "Amazon, Microsoft, Google, push back on UK regulator's cloud competition concerns", mlex, July 7.

[12] Hayashi Y. and McKinnon J. (2023), "U.S. Looks to Restrict China's Access to Cloud Computing to Protect Advanced Technology", The Wall Street Journal, July 4.

[13] Bousquette I. (2023), "The AI Boom is here. The cloud may not be ready", The Wall Street Journal, July 10; *"Much of the infrastructure wasn't built for running such large and complex systems. Cloud sold itself as a convenient replacement for on-premise servers that could easily scale up and down capacity with a pay-as-you-go pricing model. Much of today's cloud footprint consists of servers designed to run multiple workloads at the same time that leverage general-purpose CPU chips. The existing economic models of primarily the public cloud environment weren't really optimized for the kind of demand and activity level that we're going to see as people move into these AI systems. On premises, companies could save on costs like networking and data storage".*

[14] Zhang M. (2023), "Dell's Unexpected Data Centre Migration: Consequences of Cyxtera's Bankruptcy", Dgtl Infra, July 24.

[15] Avendus, Data Centres Powering Digital India, May 2023, p. 3.

[16] "Data center operator Cyxtera files for bankruptcy", *Reuters*, June 5, 2023.

[17] New Generation Research, (2023), "American Virtual Cloud Technologies Inc. – "Pure Play Cloud Communications and Collaboration Company", Files for Bankruptcy; Onetime SPAC cites Burdensome Public Company Costs, Will Continue Sale Efforts in Courts", Bankruptcy Data, January 11, 2023.

[18] Riley D. (2022), "Cloud Services Provider Sungard AS files for Chapter 11 bankruptcy", Silicon Angle, April 11.

[19] *Ibid.*

[20] "Sungard AS Successfully Completed Transactions with 11:11 Systems and 365 Data Centres", Business Wire, November 3, 2022.

[21] Judge P. (2022), "Redcentric buys remaining Sungard UK data centers from bankrupt business", DCD, June 8.

[22] Thathoo C. (2022), "Govt kicks of bid to develop National Govt Cloud, Plans 200MW Data Centre", Inc42, November 15.

[23] Jowitt T. (2022), "UK Cloud placed into compulsory Liquidation", Silicon, October 26.

[24] Donnelly C. (2021), "Cabinet Office slammed after advising users to ditch UKCloud as further investment nears", ComputerWeekly.com, November 29.

[25] *Ibid.*

[26] *Ibid.*

[27] Singh P. (2023), "India gets BCG, McKinsey to fix its digital infra. The price is more than the fee", The Ken, June 13.

[28] Ministry of Electronics & Information Technology (e-Governance Division), Data Centre Policy 2020- Draft for discussion, No.xxx/YY/2020, p. 9.

[29] Telecom Regulatory Authority of India, Recommendations on Regulatory Framework for Promoting Data Economy Through Establishment of Data Centres, Content Delivery Networks, and Interconnect Exchanges in India, , November 18, 2022, pp.14, 19, 20.

[30] "Processing" in relation to personal data, means a wholly or partially automated operation or set of operations performed on digital personal data, and includes operations such as collection, recording, organisation, structuring, storage, adaptation, retrieval, use, alignment or combination, indexing, sharing, disclosure by transmission, dissemination or otherwise making available, restriction, erasure or destruction.

[31] Section 3(27) of IBC defines property as including money, goods, actionable claims, land and every description of property situated in India or outside India and every description of interest including present or future or vested or contingent interest arising out of, or incidental to, property.

[32] PUFE stands for Preferential transactions under Section 43, Undervalued transactions under section 45, Fraudulent transactions under section 66 and Extortionate transactions under section 50 of IBC.

[33] "2e2 datacentre administrators hold customers' data to £1m ransom", Computerweekly.com, February 8, 2013.

[34] OECD publishing, Measuring the value of Data and Dataflows, OECD Digital Economy Papers, December 2022, No 345, p. 6, 27.

[35] The three commonly used methods are: market approach i.e., basis the value in market. However, active markets for data are handful with low volumes and darkweb is not an appropriate legal benchmark; income approach i.e., cash flows that are attributable specifically to the dataset and cost approach i.e., costs incurred, and investments made for that particular dataset.

[36] OaKeefe K., (2015), "Real Prize in Caesar's fight: Data on Players", the Wall Street Journal, March 19.

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[39] *Gujarat Urja Vikas Nigam v. Mr. Amit Gupta & Ors.*, 2021, The Supreme Court of India Civil Appellate Jurisdiction, Civil Appeal No. 9241 Of 2019, March 8, 2021.

[40] Master Directions on Outsourcing of Information Technology Services, RBI/2023-24/102, DoS.CO.CSITEG / SEC.1 / 31.01.015 / 2023-24, April 10, 2023.

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[43] Dobie A. (2013), "Failed Cloud Storage Provider Nirvanix files for bankruptcy", information age, October 3.

[44] "Nirvanix's demise emphasizes the need for hybrid clouds and storage mobility", Forrester, September 18, 2013.

[45] Crisanto J. et al (2022), "Big tech interdependencies – a key policy blind spot", FSI Insights - No. 44, Bank for International Settlements, July 5.

[46] Several legislation provide for Data Localization: Companies Act 2013, under section 94 require covered organizations to store data at the registered office; RBI Notification RBI/2017-18/153 DPSS.CO.OD No. 2785/06.08.005/2017-2018 dated April 6, 2018 requires all banks, system participants, service providers, intermediaries, payment gateways, third party vendors and other entities (by whatever name referred to) in the payments ecosystem, who are retained or engaged by the authorised / approved entities for providing payment services to store full end-to-end payments data in India; IRDAI Regulations requires all insurers to store insurance data within India; SEBI indirectly provides for the same by requiring the regulated entities to store data only with the data-centres empanelled by MeiTY and holding a valid Standardized Testing and Quality Certification audit status.

[47] Mehta D. (2022), "Delay in implementing cross border insolvency is detrimental to Indian creditors", *The Economic Times*, Sep 6.

[48] In Asia Data Flows are part of a new great game, The Economist, July 10, 2023.

[49] Kalman A. (2021), "Data Privacy in Bankruptcy: Towards a Deux Ex Machina", Columbia Business Law Review, March 26.

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The Intersection of ESG and Insolvency: An Exploration of Responsible Restructuring Practices in India

- Sudhaker Shukla and Asit Behera

'The greatest threat of our planet is the belief that someone else will save it'.

- Robert Swan

INTRODUCTION

The neo-classical economic model is premised on the under-examined, efficacy of all pervading 'invisible hand' in keeping the economy in the state of equilibrium, in continuum, at the state of 'Pareto Optimality'. Later it became evident that questions related to inter-generational equity from societal point of view and intra-generational equity from the point of view of sustainability and environmentally compliant behaviour was absent all together in the debate. Of late, it has become clear that economic development bereft of environmental discounting considerations is unsustainable. The expression 'The Earth has a fever' as propounded by Al Gore in his book 'An Inconvenient Truth',[1] signifies that rising temperatures of the earth is a clear signal that human activities have far exceeded the carrying capacity of the earth and unless the decisive and quick action is taken by humanity collectively, the doomsday will no longer remain the hearsay. On fostering socially and environmentally responsible behaviour, it is pivotal to re-orient the definition of economic outcomes, and the literature is abuzz with possible solutions. Environmental, Social and Governance (ESG), the subject matter of discussion of this article offers some thoughts to set the things right.

ESG criteria have risen to the forefront of corporate considerations globally. In essence, ESG refers to three key factors in measuring the sustainability and societal impact of an investment in a company or business. These criteria help to better determine the future financial performance of companies (return and risk).[2] GRI Sustainability Reporting Standards issued by the Global Sustainability Standards Board states that through their activities and business relationships, organizations can have an effect on the economy, environment, and people, and in turn make negative or positive contributions to sustainable development.[3] Sustainable development refers to 'development which meets the needs of the present without compromising the ability of future generations to meet their own needs'.[4]

An organization's activities or business relationships can exert a significant influence on the economy, environment, and individuals, inclusive of potential implications on human rights.[5] Such impacts might range from actual to potential, negative to positive, immediate to long-term, deliberate to inadvertent, and reversible to irreversible. These impacts mirror the organization's contribution, either adversely or beneficially, towards sustainable development.

In terms of economic impacts, an organization's actions can affect economic systems at the local, national, and global stages. These impacts could emanate from various operational aspects such as competitive strategies, procurement policies, and financial contributions like taxes and payments to the government. Environmental impacts encompass the influence on living entities and abiotic factors, comprising air, land, water, and ecosystems. An organization could affect the environment through its utilization of resources like energy, land, water, and other natural elements.[6] Impacts on people embody the effects on individuals or collective groups, including communities, susceptible groups, or society at large. These effects can involve potential implications on human rights. An organization might impact people *via* its employment policies (e.g., compensation structures), supply chain operations (e.g., working conditions of supplier workforce), and its products or services (e.g., safety measures or accessibility). Individuals or collectives whose interests might be influenced by the organization's activities are classified as stakeholders.

The impacts on the economy, environment, and people are intertwined. For instance, an organization's influence on economic and environmental aspects can lead to implications for people and their human rights. Similarly, an organization's beneficial impacts could potentially lead to adverse effects, and *vice versa*.

As we face a range of urgent global challenges, from climate change to social inequalities, the importance of ESG considerations in all aspects of business operations has never been clearer. Companies are increasingly recognising that their operations extend beyond pure profit-making activities, towards contributing to broader societal and environmental welfare.[7] These recognitions are not only important from a social and environmental perspective but also from an economic and business sustainability point of view. Companies with strong ESG profiles are often associated with lower risk and better profitability in the long run.[8] Investors, in particular, also use the ESG information to assess an organization's impacts and how it integrates sustainable development in its business strategy and model. They can also use this information to identify financial risks and opportunities related to the organization's impacts and to assess its long-term success.

Similarly, insolvency and restructuring laws, which traditionally focused primarily on creditors' interests, are beginning to consider broader stakeholder interests. This shift represents an acknowledgment of the wider societal role and responsibilities of corporations. The intersection of ESG and insolvency, therefore, reflects the integration of sustainability considerations into the corporate rescue mechanisms.

In the Indian context, which is characterized by a vast economic landscape, diverse corporate entities, and complex societal challenges, this intersection is particularly relevant. This article seeks to highlight the importance of ESG considerations in corporate restructuring in India and proposes potential pathways for their effective integration into the insolvency framework.

POSITION IN INDIA

The concept of responsible business is rooted in the idea that businesses owe a duty of accountability to all parties involved. Initially, this was encoded into the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs),[9] launched in 2011. Later, it was integrated into the Companies Act, 2013. This law proposed that a company and its directors have broader obligations, extending beyond shareholders to include stakeholders like employees, the community, and the environment. In response to global trends and domestic modifications, these NVGs were revised and modernized, resulting in the National Guidelines for Responsible Business Conduct in the year 2019.[10] Also, from 2012 onwards, the Securities and Exchange Board of India made it compulsory for the top 500 listed companies (ranked by market capitalization) to provide information on business responsibility and sustainability, as outlined in the NVGs, through Business Responsibility Reporting (BRRs).[11]

ESG CONSIDERATIONS IN CORPORATE INSOLVENCY

Globally, there is an increased recognition of the need to integrate ESG considerations into corporate insolvency laws. This development is anchored on the realisation that companies operate within a broader societal context and should therefore be accountable to a wider range of stakeholders beyond their creditors and shareholders.[12] These stakeholders are individuals or groups that have interests that are affected or could be affected by corporate debtor's (CD's) activities. Common categories of stakeholders for organizations are business partners, civil society organizations, consumers, customers, employees and other workers, governments, local communities, non-governmental organizations, shareholders and other investors, suppliers, trade unions, and vulnerable groups. Stakeholders may not always maintain a direct connection with the company. For instance, individuals or communities residing far from the organization's operational sites might experience or potentially experience effects from the operations of the company.[13] They might not realize their stakeholder status with the company, especially if the company's activities haven't impacted them yet. The company bears the responsibility of identifying the concerns of such stakeholders, along with those who are unable to express their viewpoints, such as future generations.

The Insolvency and Bankruptcy Code, 2016 (IBC/Code), is the primary legislation governing insolvency and restructuring in India.[14] However, the IBC does not explicitly incorporate ESG considerations. The focus remains primarily on maximising the value of assets in terms of the long title of the Code.

THE CASE FOR ESG INTEGRATION IN INSOLVENCY AND RESTRUCTURING

The restructuring process provides an opportunity for corporates to redefine their strategic priorities and re-orient their business models. Integrating ESG considerations can help facilitate long-term sustainability and competitiveness.[15] The inclusion of ESG factors in the restructuring process also aligns with the broader purpose of insolvency laws - to preserve the economic value of companies and to keep them as a going concern. This was exemplified in various pronouncements by the Courts.

The World Bank is implementing a new corporate flagship, Business Ready (B-READY),[16] to assess the business and investment environment worldwide annually which replaces the 'Doing Business' Report. The Business Enabling Environment which is the new benchmarking exercise will also address environmental obligations in bankruptcy and review good environmental regulatory practices within insolvency proceedings.[17] The Business Insolvency indicators will consider elements of social significance related to insolvency such as the environmental, and labour claims or any other related social policy interests that may arise by operation of the law.[18]

A case for ESG

A CD undergoing insolvency is inherently akin to a brownfield project. In the realm of development and business, the distinction between 'greenfield' and 'brownfield' projects is analogous to building afresh vs rebuilding or refurbishing.[19] While greenfield projects refer to starting from scratch on untouched land, brownfield projects involve reviving or expanding existing structures or facilities. Given the fact that our planet offers limited resources, it's evident that there is a finite number of greenfield projects it can accommodate. Consequently, the significance and value of brownfield projects, such as the restructuring or revival of insolvent corporations, are poised to grow exponentially in the forthcoming era.

Incorporating ESG factors during a corporate insolvency process in India can provide several benefits, similar to those in a restructuring process. Here's how:

1. **Risk Management:** ESG factors can help identify potential risks that might not be apparent through traditional financial analysis. For example, a company with poor environmental practices might face regulatory fines or reputational damage that could impact its financial performance.[20] This is particularly important in India, where environmental regulations are becoming increasingly stringent. Identifying these risks early can help shape the insolvency process and ensure a smoother resolution.

2. **Operational Efficiency:** ESG factors often align with operational efficiency. For example, environmental considerations can lead to energy efficiency and waste reduction, which can lower costs.[21] This can be particularly beneficial during an insolvency process, where cost reduction is often a key focus.

3. **Investor Appeal:** ESG factors are increasingly important to investors. Companies that can demonstrate strong ESG performance may attract investment from socially responsible funds and other investors who consider ESG factors.[22] This can be particularly beneficial during an insolvency process, where attracting new investment can be crucial.

4. **Stakeholder Engagement:** Considering ESG factors can improve relationships with stakeholders, including employees, customers, and the local community. This can enhance a company's reputation and brand value,[23] which can be particularly valuable during an insolvency process. In India, where many businesses play a significant role in their local communities, this can be particularly important.

5. **Legal Compliance:** Compliance with ESG-related laws and regulations can prevent potential legal issues[24] that could disrupt the insolvency process. This includes laws related to environmental protection, labour rights, and corporate governance. Non-compliance can result in fines, legal action, and reputational damage, all of which can complicate the insolvency process and harm the company's long-term prospects.

6. **Long-Term Sustainability:** Incorporating ESG factors can help ensure the long-term sustainability of the business.[25] This can be particularly important during an insolvency process, as it can help the business emerge in a stronger position. For example, a company that takes steps to reduce its carbon footprint or improve its corporate governance practices is likely to be better positioned for success in a world where these factors are increasingly important.

7. **Competitive Advantage:** Companies that effectively incorporate ESG factors can differentiate themselves from their competitors, potentially gaining a competitive advantage. This could involve developing environmentally friendly products or services, adopting more ethical business practices, or demonstrating superior corporate governance. These factors can make a company more attractive to customers, investors, and potential employees, giving it an edge over its competitors.

Incorporating ESG factors into an insolvency process requires a strategic approach. It's not just about mitigating risks, but also about identifying opportunities for improvement and growth. By considering ESG factors, companies can create an insolvency plan that not only addresses immediate financial and operational issues but also positions the company for sustainable success in the future.

Pathways for ESG integration in Indian insolvency law

Identifying the importance of incorporating ESG considerations into corporate insolvency practices in India, the authors propose several pathways for potential legal and policy developments:

1. **Amendment of Existing Legislation:** The IBC could be amended to explicitly consider ESG factors in the insolvency and restructuring process. This would necessitate changes to the relevant provisions of the Legislation. For starters, section 30(2) of the Code could be revised to mandate the incorporation of ESG factors in the evaluation of resolution plans. This would align with the broader aim of preserving the economic value of companies, promoting sustainable business practices and considering the interests of a larger group of stakeholders. Additionally, the role of the Resolution Professional (RP) could be expanded to include a duty to consider and address ESG risks and opportunities.

2. **Regulatory Guidelines**: The Insolvency and Bankruptcy Board of India (IBBI) may issue certain guidelines in the beginning requiring RPs to consider ESG factors when considering resolution plans by incorporating certain points to the Evaluation Matrix[26] (EM) in a plan. These guidelines could set out specific ESG criteria to be considered and the process for their integration into resolution plans. This approach would provide flexibility, allowing for the consideration of ESG factors to be tailored to the circumstances of each case and sector. With due process of time and experience of incorporating of such criteria, such ESG factors may be made mandatory.

3. **Voluntary Commitments:** CDs and RPs could voluntarily commit to integrating ESG considerations into the insolvency process. These commitments could be guided by global best practices and standards.

4. **Judicial Pronouncements:** The Judiciary could also play a significant role in integrating ESG considerations into insolvency and restructuring processes by interpreting existing legal provisions in a way that incorporates ESG principles. The courts, using their inherent powers as they have done from time to time, could take a more proactive role in incorporating ESG considerations into insolvency decisions.

5. **Stakeholder Pressure**: Stakeholders, including creditors, employees, and customers, could exert pressure on CDs and RPs

to consider ESG factors. This could be accomplished through activism and engagement in the resolution process.

6. **Training and Capacity Building**: Lastly, there needs to be a concerted effort to enhance the understanding and capacity of insolvency professionals, as well as other relevant stakeholders, to deal with ESG issues. This could be achieved through the development of dedicated training programs and resources.

Choosing ESG factors

The approach for choosing considerations will vary according to the specific circumstances of the CD, such as its business model; sectors; geographic, cultural, and legal operating context; ownership structure; and the nature of its impacts. The guidelines may be introduced sectorally and topic wise. Examples of material topics may be occupational health and safety, or water and effluents. A topic need not be limited to impacts on the economy, the environment, or people; it can cover impacts across all three dimensions. For example, an EM might determine that 'water and effluents' is a material topic based on the impacts its water use has on ecosystems and local communities' access to water. The committee of creditors (CoC) shall oversee the process, review it and approve the considerations in the EM.

Steps for choosing ESG considerations

The following steps may be followed for choosing ESG considerations:

Step 1: Identification

The RP generates an initial synopsis of the CD's operations and business relationships, the sustainability milieu within which these exist, and a summary of its stakeholders. This furnishes the members of CoC with pivotal information for discerning its real and potential impacts. This may be integrated into the Information Memorandum.[27] The RP might evaluate the operations, business relationships, stakeholders, and sustainability context of all entities under its control or in which it holds an interest (such as subsidiaries, joint ventures, affiliates), encompassing minority interests. Relevant divisions and functions within the CD, like human resources, investor relations, legal and compliance departments, marketing and sales, procurement, and product development, may aid the RP in this process.

In relation to the CD's operations, the RP should examine the following aspects in terms of above:

- The CD's guiding principles, value propositions or mission statements, business architecture, and strategic plans. It should consider the range of activities undertaken (for instance, sales, marketing, manufacturing, distribution), and the geographical areas where these activities take place.

- The array of products and services the CD provides and the markets it caters to. This includes understanding the kinds of customers it aims to serve and the geographic areas where its products and services are available.
- The sectors the CD operates within and their unique attributes (for example, whether they involve informal labour, or whether they are labour or resource heavy).
- The employee count, including the nature of their employment whether full-time, part-time, non-guaranteed hours, permanent or temporary and their demographic profiles (such as age, gender, geographic location).
- The number of workers not classified as employees but whose labour is controlled by the CD. This includes understanding the nature of the workers (for example, agency workers, contractors, self-employed persons, volunteers), their contractual relationship with the organization (that is, whether the organization engages these workers directly or indirectly through a third party), and the tasks they undertake.

The RP should then identify who its stakeholders are across its activities and business relationships and identify its impacts. When identifying its stakeholders, the RP should ensure it identifies any individuals or groups it does not have a direct relationship with. Different lists of stakeholders can be drawn by the RP as per activity, project, product or service, or any other classification that may be suitable.

Step 2: Impact assessment

During this stage, the RP determines the actual and potential implications of the CD on the economy, environment, and individuals, factoring in impacts on human rights, throughout the CD's business operations. Actual impacts refer to those that have already transpired, whereas potential impacts are those that could materialize but haven't yet occurred. These impacts can encompass negative and positive effects, immediate and long-term consequences, intentional and unintentional implications, and reversible and irreversible outcomes.

As part of the initial impact assessment or scoping exercise, the RP should consider impacts commonly associated with its sectors, its products, geographic locations, or with specific organizations (i.e., impacts associated with a specific entity of the organization, or with an entity it has a business relationship with, such as a poor history of conduct in relation to respecting labour rights).

To discern these impacts, the RP can leverage information from various sources. Initially, it can use readily available information about impacts on the economy, environment, and people, including implications for their human rights. As time progresses, the RP can consider third-party assessments. The RP can also utilize information from financial audits, labour inspections, and regulatory filings. Moreover, it can rely on data from any other pertinent evaluations of business relationships conducted by the organization or industry or multi-stakeholder initiatives.

Step 3: Positive and negative factors for assessment

Taking into considerations, the inputs from Step 1 and Step 2 above, the RP shall formulate ESG considerations that may suitably fit within the EM for the CIRP. The factors should assess the manner in which a resolution applicant may contribute or could contribute to sustainable development through its activities, for example, through its products, services, investments, procurement practices, employment practices, or tax payments. This also includes assessing how the resolution applicant can shape the CD's purpose, business model, and strategies to deliver positive impacts that contribute to the goal of sustainable development. An example of a positive impact is a resolution applicant adopting measures that increase the usage of renewable energy thus contributing to mitigating climate change. Another example is a resolution applicant choosing to have more number of hirings to open a new facility so that it can hire and train unemployed members of the local community, and in this way, contribute to job creation and community development. Another example maybe a CD in the oil and gas sector which often require land for operations, access routes, and distribution. This can lead to impacts such as involuntary resettlement of local communities, which can involve their physical displacement and economic displacement through lost access to resources. Thus, a resolution plan which does not result in physical displacement is a positive factor.

CONCLUSION

ESG considerations shall play a critical role in achieving sustainable corporate restructuring in the future. The intersection of ESG and insolvency presents a unique opportunity for corporate restructuring in India. By integrating ESG considerations into the insolvency and restructuring processes, companies can not only improve their risk management and operational efficiency but also enhance their appeal to investors, engage more effectively with stakeholders, and ensure their long-term sustainability. It will also help in improving our ranking in the soon to be rolled out B-READY corporate flagship benchmarking exercise. Also, such an approach is in line with the broader societal role and responsibilities of corporations, a shift that is being increasingly recognized in insolvency laws globally. It's time for India to seize this opportunity and build a more sustainable and resilient corporate sector. As we advance into the future, the onus is on us to ensure the effective greening of these brownfield projects. This doesn't merely imply environmental considerations but encompasses a holistic transformation that leverages cutting-edge technology, effective and sustainable planning, and robust legal frameworks. Crafting regulations, tailoring laws, and enforcing necessary compliances are all crucial steps in paving the way for a more resilient and sustainable future. By harnessing technology and fortifying our legal frameworks, we can ensure that brownfield projects not only revitalize corporations but also contribute positively to our planet and its stakeholders.

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IBC - Preparing for Version 2

- Ashok Haldia

IBC SO FAR AND VISION

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) has been one of the biggest economic reforms that the Government has implemented in 2016 for resolution of mounting stress in corporates, and maximization of realization of economic value blocked therein.

After over six years, IBC has, to a large extent, been able to achieve what it was set out for considering the circumstances and limitations posed by the ecosystem at the time it was legislated in 2016. With its success and emerging challenges, expectations of stakeholders have increased particularly in regard to percentage of realisation, time taken in resolution, cost of resolution and prolonged litigation.

The Insolvency and Bankruptcy Board of India (IBBI/Board) has been proactive in addressing the issues and difficulties arising during corporate insolvency resolution process (CIRP). Judicial pronouncements, from time to time, have resolved many interpretational and legal hurdles. Insolvency Professional Agencies (IPAs) like IIIPI of ICAI have done considerable work in capacity building of Insolvency Professionals (IPs) and creating awareness in understanding of different stakeholders about IBC and their respective roles. IPs themselves have done very well in translating IBC into a reality at ground level, overcoming teething troubles. In substance, IBC has played an important role in creating an ecosystem for resolving stress in industry, reducing time in resolution thereof and salvaging economic value of distressed assets.

The success of the Code over last six years since its inception, as stated, has not only increased expectations for much better outcomes but has also made it imperative to address the difficulties and challenges faced so far. The ecosystem surrounding stressed assets and IBC now is much different than what it was pre 2016. There is an imminent need to deliberate and work upon what needs to be over a period of next five years. IBC deals with dynamic, economic, financial and industrial environment as it develops and therefore a long-term horizon for next 10 or 25 years may not be productive.

MEASURES NEEDED

From this perspective, following measures are required in order to extend the application of the Code to cover important issues not considered in IBC in 2016 due to complexity involved and for waiting till IBC ecosystem matures:

a) **Mechanism for group insolvency**: Most of the corporates have subsidiaries and associates with inter-se economic, financial and operational interests. This causes complexities, legal huddles and consequent delays in resolution. Based on the recommendations of a Committee set up by the Ministry of Corporate Affairs (MCA),

MCA has issued a discussion paper providing for procedural and substantial consolidation. There is sufficient international experience available as well to deal with legal and implementation issues.

b) **Mechanism for cross-border insolvency**: IBC does provide for cross-border insolvency by empowering the Central Government to enter into bilateral agreements with foreign jurisdictions in order to resolve the issues of cross-border insolvency. It further empowers the Adjudicating Authority (AA) to issue a letter of request to courts of the country/ies where the corporate debtors (CDs) have economic, financial or operational interests and with which the Government has entered into bilateral agreement. However, cases of CDs having foreign subsidiaries or associates have considerable issues and challenges in the absence of a clear framework on institutional and procedural aspects. The Insolvency Law Committee of MCA has suggested, as a workable solution, for adoption of the UNCITRAL Model Law on Cross-Border Insolvency which has also been accepted in most of the jurisdictions worldwide.

c) **Pre-packaged insolvency for non-MSMEs as well**: Pre-pack insolvency mechanism introduced during COVID-19 period provides for an efficient and cost-effective outcome out of court, while ensuring continuity of underlying business. Well intended though, it has not proved successful, with only a handful of micro, small and medium enterprises (MSMEs) opting due to lack of awareness and procedural difficulties. It being an out of court and amiable resolution for all stakeholders, should be extended to non-MSMEs as well while addressing procedural difficulties experienced.

NEW INITIATIVES ENVISAGED BY THE REGULATOR

MCA and IBBI have initiated certain changes in IBC and its regulations, to address the imminent challenges before IBC. A number of discussion papers have been released by MCA and are in pipeline for further action. These include:

a) Use of technology in the IBC ecosystem

b) Restricting the right of the promoters to propose an Interim Resolution Professional

c) Empowering the AA to impose penalties for violations of the Code

d) Expanding the applicability of the pre-packaged insolvency resolution framework

e) Incentivising interim finance providers

f) Improving outcome of real estate cases

g) Resolving issues in regard to inter-dependent (group) entities

h) Expanding scope of pre-packaged insolvency framework

i) Empowering IPs to finalize list of assets in certain situations

For some of these, discussion papers were floated by MCA/IBBI for inviting comments from the stakeholders. It is time to implement those after consideration of comments received from the stakeholders. Reforms related to group insolvency, cross-border insolvency and certain critical implementation issues require immediate action.

REAL-ESTATE PROJECTS: ADDRESSING EMERGING DIFFICULTIES AND CHALLENGES

Insolvency resolution of CDs in real estate sector is a different ball game than of other CDs and need a different or modified version of IBC. Allottees or applicants of a real estate project are now treated as financial creditors (FCs). However, their position and interests are different than other FCs such as lenders in nature, rights, and quantum, with their life savings and aspirations at stake, though amount involved may be small unlike FCs. Their interest lies in possession of house and not in recovering of amount deposited with the developer. Another issue is whether or not, and, if yes, under what circumstances one or more projects by the same developer should be considered for stress resolution in a particular project.

To protect the interests of allottees, several judicial interventions have been made such as 'reverse CIRP' and 'project-specific resolution'. However, for want of clarity and regulatory provisions on the subject, many CIRPs of real-estate cases are languishing in courts. It is, therefore, necessary that IBC should provide for a specialised framework for real estate projects. The discussion paper by MCA referred to earlier, does provide for such a dispensation. The proposals in the said discussion paper attempts to remove anomalies noted above and creates a conducive framework keeping in mind the peculiarities involved. Another area to be addressed is lack of coordination between IBC and Real Estate Regulatory Authority (RERA) framework as a sector specific law. RERA provides largely a *in personam* dispensation while IBC provides *in rem* dispensation. Further, unlike under RERA, proceedings under IBC are considered non-adversarial in nature. In view of the non obstante provision, IBC provisions would have an overriding effect. Given some amount of overlap between the two frameworks, there is a need to create a mutually harmonised framework.

NEW INITIATIVES NEEDED

a) More focus on mediation under IBC

IBC needs to encourage and emphasise on mediation as a first step. It needs suitable amendments in regard to moratorium for ongoing civil proceedings and making mediated settlements binding and enforceable. It also needs regulations for streamlining and bringing in transparency in pre-mediation, mediation and post mediation process. IBC law and practice, in fact, should encourage and emphasise on stress resolution by the CD together with stakeholders or, through other alternative mechanisms before CD is required to take recourse to legal or judicial mechanism under IBC.

b) Promoting and emphasizing technology application in IBC process

Technology has transformed regulatory compliance and enforcement in regulatory requirements. Pre and post CIRP processes, and interface between AAs, IBC, IPAs, committee of creditors (CoC) and IPs need to be based on the use of technology, artificial intelligence, and data analytics. This would be useful in streamlining the processes, documentation, and regulatory oversight considerably reducing the cost and time in resolution.

c) Addressing legal hurdles

From time to time, many judgements of Hon'ble Supreme Court, National Company Law Appellate Tribunal (NCLAT), National Company Law Tribunal (NCLT) and the Government through amendments in IBC, have provided much needed clarity and balance between intent of law and its practice. However, there have been instances where judicial pronouncements do not appear to be consistent with the intent of law. Lack of clarity in IBC and in relevant regulations, have also resulted in a large number of litigations and mounting legal cost and delays.

d) Institutional strengthening and capacity building

i) Apart from changes required in IBC for streamlining the interface of different stakeholders with NCLT, causing unnecessary or frivolous litigation and delays, NCLT needs to be strengthened by increasing number of benches and timely appointment of its members. Digitisation of NCLT and interface of internal proceedings in NCLT needs to be expedited. Time has come that specialised benches in NCLT and NCLAT are set up considering size and nature of CDs and commercial nature of issues involved in CIRP.

ii) IPs are important for successful implementation of IBC at ground level. Their contribution in success of IBC so far has been significant. They however need to strengthen themselves by developing corresponding organisational capabilities, digitisation and adaptation of technology, and capacity building to enable CIRP of different sizes and complexities of CDs and to co-op with new developments like cross-border insolvency, group insolvency and mediation. IPAs need to organise and prepare themselves as well as IPs for emerging and imminent developments as mentioned earlier.

iii) CoC needs to be made more accountable for participation and timely decisions in the matters placed before CoC. Similarly, banks are required to be made accountable for taking timely decisions on matters related to IBC. The Code should facilitate commercial decisions at all levels in a fair and transparent manner without fear of being questioned by vigilance or enforcement agencies without establishing *mens rea.*

CONCLUDING THOUGHTS

IBC has been successful in achieving objectives for which it was enacted in 2016. However, expectations of stakeholders have increased and rightly so with the changing ecosystem. The extent of haircuts need to be reduced and so the time taken and costs under IBC till resolution or liquidation. The Government has been proactive in responding to challenges. However, new measures initiated need to be implemented early by legislative changes or institutional strengthening. At the same time, level of awareness and appreciation of realities of corporate stress and limitations posed by those, is required to be enhanced among different stakeholders. The Board of IIIPI of ICAI has set up a Committee to suggest vision and measures for IBC- Version 2, and for strengthening IIIPI and IPs for this. The Report of the Committee will be shared in public domain when the same is ready.

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Mr. Vinod Kothari is a Fellow member of the Institute of Company Secretaries of India (ICSI) and an Associate member of the Institute of Chartered Accountants of India (ICAI). With an experience of over 35 years in field of corporate law advisory services, Mr. Kothari was one of the first Insolvency Professionals in India. He is the author of 15+ books on diverse topics, including one of the first books on the Insolvency and Bankruptcy Code, co-authored with Ms. Sikha Bansal, titled Law Relating to Insolvency and Bankruptcy Code, 2016, another on Securitisation, Asset Reconstruction and Enforcement of Security Interests and so on. Backed by practical experience as the Insolvency Professional in several matters, he has been widely renowned for consultancy under the Insolvency and Bankruptcy Code also. An accredited and regular speaker at the IIM-C, ICSI, ICAI, ICMA and other professional forums, he has conducted seminars in over 30 jurisdictions all over the world.

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Ms. Sikha Bansal is an Associate Member of the Institute of Company Secretaries of India and had secured all India rank in examinations conducted by the Institute. Her core area of expertise include insolvency law, law on security interests, corporate laws and financial regulations. She is the co-author of the book titled Law Relating to Insolvency and Bankruptcy Code 2016 and has authored several articles on subjects pertaining to insolvency law. She has been engaged extensively in resolution/liquidation matters as well as advisory under the Code.

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Ms. Vartika Misra is working as a Research Associate with Adjudication and Prosecution Division of the Insolvency and Bankruptcy Board of India, where she looks after the complaint/prosecution matters and litigation matters before various Courts, while undertaking research on various legal issues under IBC. She has completed Master's in Criminal Law from the Indian Law Institute in 2021 after having completed her graduation in law from Guru Gobind Singh Indraprastha University in 2020. She has a keen interest in the field of restructuring and insolvency, arbitration, and criminal law owing to prior research experience in these fields. She has been associated with research in fields of Global Justice and TWAIL Approaches, Global Health Development on the touchstone of ethics and law, owing to prior publications on the respective themes.

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Mr. Sudhaker Shukla

Mr. Sudhaker Shukla took charge as Whole-time Member, IBBI on November 14, 2019. He served as a member of the Indian Economic Service for over 34 years in various capacities across Ministries and Departments of the Government of India and represented India, in the Board of the African Development Bank. He is currently looking after Corporate Insolvency, Corporate Liquidation (including Voluntary Liquidation), Individual Insolvency and Bankruptcy, Data Management & Dissemination, Legal Affairs, Adjudication, Prosecution and Court Proceedings. In addition, he is also handling IT, IBC-21, Vigilance, Board meetings, Strategy, Communications, Parliament and FSDC related matters in the IBBI.

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Insolvency and Bankruptcy Board of India

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