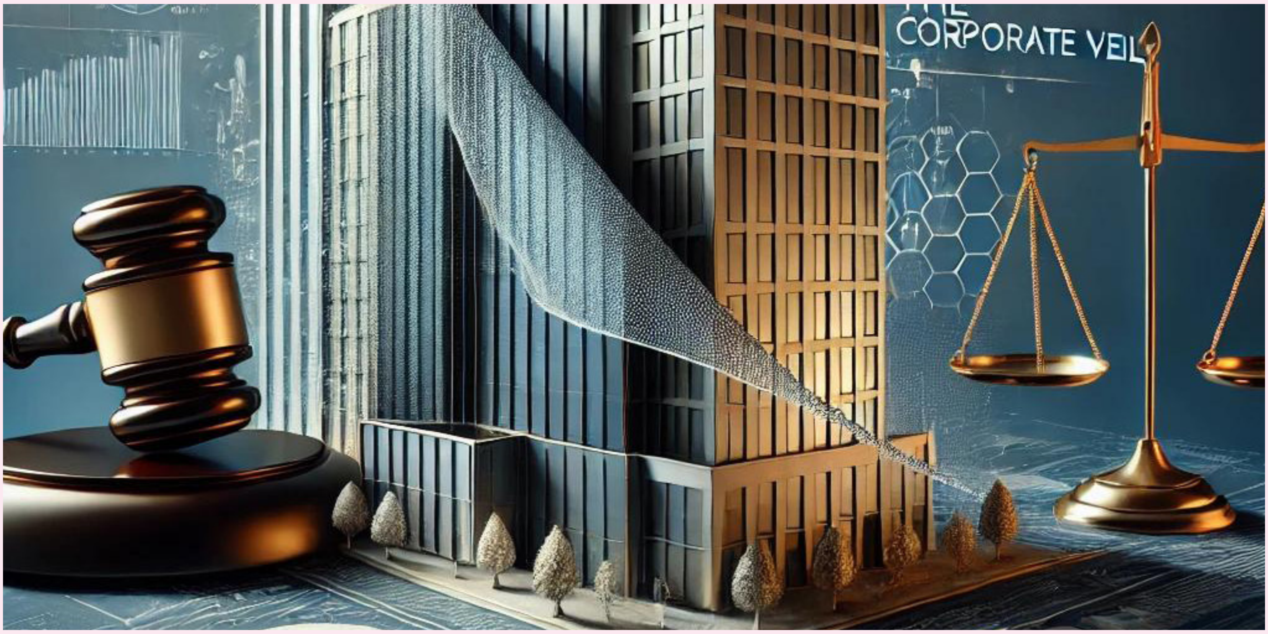
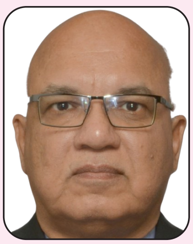
Group Insolvency: Lifting the Corporate Veil - A Contrarian View





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The lack of a suitable framework for Group Insolvency under the Insolvency & Bankruptcy Code, 2016 (IBC) has been a matter of discussion for past many years. The Insolvency & Bankruptcy Board of India (IBBI) engaged with this issue by forming a Working Group on Group Insolvency. Subsequently, the Ministry of Corporate Affairs (MCA) invited suggestions for amendments to strengthen the IBC's framework for Group Insolvency. Meanwhile, the NCLTs, by using their inherent jurisdiction have decided several matters of interconnected entities through judicial orders. This article explores the complexities related to insolvency cases of interconnected entities in the absence of a Group Insolvency framework and suggests measures for a robust Group Insolvency framework under the IBC such as widening the scope of interconnected entities to include societies, trusts etc. ***Read on to know more….***

1. Introduction

It has been almost eight years since the Insolvency & Bankruptcy Code, 2016 (IBC/Code) was introduced to provide corporates in India with the third leg of the corporate reforms process viz. the proverbial 'exit' option. The IBC seeks to offer this option in a much more transformative manner than the 'restructuring' schemes introduced by the Reserve Bank of India (RBI) in the first decade of this century. The latter were occasioned by the huge pile up of Non-Performing Assets (NPAs) at banks which not only impacted their balance sheets requiring the Government of India to pump in capital in the Public Service Banks (PSBs) but also impacted their ability to write new corporate loans, hindering economic activity. These measures, however, ended up providing the promoters of corporate businesses the means to retain their 'unholy' control over the businesses and kick the can down the road with tacit support of the lenders. Consequently, the fundamental role of banks as a catalyst in the country's economic growth stood squarely defeated.

The advent of IBC and the initiation of Corporate Insolvency Resolution Process (CIRP) against banks' top 12 NPAs brought about a culture of corporate accountability like never before and significantly improved credit discipline. As such, today the Banks' NPA levels are far lower with hardly any major slippages, resulting in better profitability parameters eschewing the need for PSBs to approach the Government of India for capital infusion.

However, after almost eight years since IBC's introduction, not everything is as it should be. The resolution process is taking on an average 585 days[1] (excluding the time excluded by the AA) as on December 31, 2024, for conclusion of process, as against the stipulated maximum 270 days including 90 says extension by the AA. The admittance of fresh cases takes forever (over a year in many cases) given the weak legal infrastructure and lack of substantive accountability of Adjudicating Authorities (AA) in respect of timelines. While the pace of resolutions has improved, the levels of recoveries are disappointing; 27% in 2023-24 compared to 36% in 2022-23. The cumulative levels of recovery, since the introduction of IBC, stand at 32.10% as of December 31, 2024.

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This has led to the Insolvency and Bankruptcy Board of India (IBBI/ Regulator) going into a high-octane mode to improve the efficiency of the process by addressing issues of law as they come up. IBBI attempts to do this through introduction of amendments to regulations and is also seeking to make substantive changes on the largely unaddressed issues of Cross Border Insolvency, Group Insolvency, sector -specific issues e.g. real estate etc. IBBI has proactively amended extant regulations whenever an issue of legal interpretation has cropped up in the bankruptcy ecosystem.

This article, while focusing on the issue of Group Insolvency, argues that IBC is fundamentally a commercial law. Hence, by its very nature, it cannot attempt to address every specific issue as it crops up occasioned by the unique nature of the case/s under resolution. The Code and Regulations are robust in themselves, and the practitioners need to simultaneously respect the hierarchy of jurisprudence while taking case-specific legal decisions.

2. Functioning of Interconnected Entities

A typical scenario in a group of business entities having a common promoter and a common core activity is best envisaged by the following example. Mr. X, with some dormant family members as directors, floats a listed company for the sole purpose of setting up and running hospitals all over the country. This company functions like a holding company, drawing royalties from the hospitals for consultancy support and other activities. The hospital buildings belong to a wholly owned unlisted company which raises loans from banks for their construction. The construction is undertaken by group subsidiary companies, majority owned by the promoter and his non-corporate affiliates. Additionally, the service contracts for the day to day operations of the hospitals are with promoter owned non-corporate entities. These entities are paid every month by the hospitals from designated bank accounts on contracted rates. The revenues of all the hospitals go directly to the accounts of related Trusts where the promoter or his family member is the Managing Trustee for life, to be replaced, when necessary, only by another family member. These Trusts, in turn, pay the respective hospitals at scheduled rates as per a tripartite agreement with the hospitals and the lead lender in their Trust and Retention Account (TRA) accounts maintained with the lead bank's branches. This enables the respective hospitals to pay the doctors, technicians and admin staff salaries, banks' loan dues, defray day-to-day running expenses as also pay the charges of the support service agencies.

[1] IBBI Newsletter, October-December 2025 (https://ibbi.gov.in//en/publication)

In the initial stages everything works clockwork and various agencies dealing with the group entities are comforted that they are dealing with the group as a whole, helmed by the individual promoter. It is a common practice and perfectly reasonable for commercial ventures to operate through groups of entities and for each entity in the group to have a separate legal personality. Separate entities are set up in order to dissociate specific assets from general liabilities, the purpose being to raise funding on more favorable conditions.

> **Till the time interconnected entities are solvent and operational, the general perception is typically that they function as a unified group.**

When these businesses are solvent and operational, general perception is typically that they function as a unified group in the eyes of customers, suppliers, creditors etc. Nevertheless, as a normal credit risk measure, lenders often seek guarantees or credit support from ultimate parent and the principal individual promoters, which are readily provided. Formal divisions are ignored under the impression that they are dealing with the group as a whole identified with the promoter. Consequently, a sense of complacency gradually sets in with all agencies, including lenders, dealing with any of the group entities.

However, the use of the group structure presents the promoters and their key personnel with opportunities for manipulating the corporate form, evading regulations and responsibilities. Annual reports can be manipulated by concealing losses using intra-group transactions designed to create profits. Assets can be transferred around the enterprise with no proper book-keeping; intra-group claims are unascertainable, etc. The result is significant confusion as to inter se liabilities as well as asset ownership.

In the specific example provided above, the promoters gradually began to betray the trust reposed in them by, inter alia, the lenders who have the overwhelming exposure to the group. The hospitals discontinue the service contracts with the group entities which were monitored by banks and awarded them to 'related' entities outside the group on terms not disclosed to the banks. The hospitals, on the pretext of poor service, opened current accounts with other banks outside the consortium and the Trusts started paying the hospitals their monthly dues into those accounts. The banks, which initially, during the bonhomie period, received their full loan instalments, later started receiving paltry amounts against their dues with the promoters citing poor business conditions due to increased competition and regulatory control on charges leviable for treatments coupled with rising costs. Accordingly, the promoter enjoined the banks to restructure the dues several times under one or the other RBI restructuring schemes on the pretext that the business revenues were inadequate to service the accounts at the agreed levels. Finally, when the promoter ran out of the restructuring schemes, and the banks started running out of patience contemplating action under SARFAESI etc., the promoter quietly took the shield of IBC and filed for insolvency.

> **In the time of financial crisis, the interconnected entities dissociate themselves from agreements and common accounts and start operating as independent units.**

The historical approach to these situations has been that, regardless of the fact that a legal entity is or is not part of a group of companies, if insolvency occurs it is traditionally considered a stand-alone body, solely liable for its own debts with only its own assets. This approach ignores that, during its lifetime, the company was part of a larger economic entity and has always been treated as such. The size and complexity of many enterprise groups is not always readily apparent, as the public image of many is simply that of a unitary organization operating under a single corporate/promoter identity. Indeed, that may reflect not only the public view but also the internal concept within the organization - the legal structure of a group as a number of separate legal entities is seldom indicative of how the business of the group is internally managed. The interrelationships between group members that determine the manner in which the group operates while solvent is generally severed on the commencement of insolvency and restructuring proceedings.

3. Group Insolvency and the IBC

In the case discussed above, since the Trusts and also the legal form of other group entities, like hospital societies and LLPs, were outside the ambit of IBC, the lenders could not access the fund streams going to the company's current accounts with other banks. Clearly, they have been shielded from the banks by design (almost like a pre-meditated plan) with the advantage of IBC not extending to such non-corporate entities. Consequently, the loan accounts turned NPAs. The subsequent Transaction Audits during the CIRP based on whatever records which could be accessed in the opaque group organizational set up disclosed huge irregularities with regard to the nature of suspicious transactions forcing the banks to declare the company fraudulent and the promoter as a willful defaulter.

Therefore, there is a need for widening the MCA definition of 'group' to include non-corporate entities like Trusts, Societies, etc. while retaining the significant control and substantive ownership aspects for determination of the 'group' character. In India, given the preponderance of family structures even in large conglomerates, this is necessary for enabling the courts to determine the need for lifting the corporate veil. Moreover, the definition of 'related parties' under Section 5(24) of the IBC, which covers group corporates, LLPs and KMPs would need to be widened to include non-corporate structures like Societies, Trusts, Hindu Undivided Family (HUF), etc. which are engaged in a broad common economic activity in an inter-connected way. As such, in the instant case under discussion, considering that all entities were engaged primarily in the single activity of operating hospitals, this is a fit case for collapse of group structure by piercing the corporate veil and ordering 'Substantive Consolidation' (aggregation of assets and liabilities of all group entities) as against a 'procedural coordination' (simultaneous insolvency proceedings against all group corporate entities). Here, unless consolidation is ordered, it would be difficult to achieve an effective resolution of the hospital owning company. Absence of a consolidation is likely to result in inefficiency; loss of value; lack of coherence; multiplication of cost; conflicting decision making; added uncertainty of outcome. Generally speaking, if consolidation is ordered, it would be in the interest of the creditors. Creditors will

suffer a greater prejudice in the absence of consolidation than the insolvent companies and objecting creditors would from its imposition. As all the above factors would stand in the way of maximization of value, it would be well-nigh impossible to achieve a satisfactory outcome of resolution process. Secured creditors of defaulting companies will suffer greater prejudice in the absence of consolidation.

> **The definition of 'related parties' under Section 5(24) of the IBC, needs to be widened to include non-corporate structures like Societies, Trusts etc.**

In the alternate case of a 'procedural coordination' of a Group, it is fit to initiate CIRP against group corporate entities before a single NCLT bench. The CBIRC (Cross Border Insolvency Rules/Regulations Committee) set up by the MCA had, in their Report dated December 10, 2021, reiterated certain broad suggestions of the IBBI constituted Working Group (WG) on the operational methodology for CIRP under procedural coordination. The Working Group, in the recommendations[2] made in the report dated December 10, 2019, had stated that the Group Insolvency framework should be 'enabling' in nature for voluntary adoption by the stakeholders. It should be introduced in a phased manner starting with procedural coordination for group corporates (holding, subsidiary and associate) with some flexibility on the grouping left to the AA; subsequently cross-border and substantive variants could be introduced. The WG envisaged certain mandatory provisions like a

[2] IBBI's Working Group Report, dated 12.10.2019.

joint application for insolvency, communication and information sharing among group committee members, single IP and single AA with a group coordination structure between different lenders to the group entities. This is yet to be formalized.

4. Judicial Initiatives on Group Insolvency

In the case under discussion, we need to be cognizant that IBC is fundamentally a commercial law, and the adjudicators have the responsibility of promoting the objectives of the Code. As such, in the absence of specific provision, National Company Law Tribunal (NCLT) can order substantive consolidation and other suitable steps in this case, by exercising its inherent powers under Rule 11 of the NCLT Rules, 2016, to meet the ends of justice, in the interest of the secured creditors and other stakeholders, and to serve the larger objectives of the Code. It is the duty of NCLT to act in a manner that advances the objectives of the Code and not defeat them, by being innovative and creative. NCLT should be progressive and fill the legislative gaps by judicial decisions making and interpretation of law. In the epilogue to its decision in *Swiss Ribbons Pvt. & Anr. v. Union of India & Ors.*[3], the Supreme Court observed, "The Insolvency Code is legislation which deals with economic matters and, in a larger sense, deals with the economy of the country as a whole. Earlier experiments, as we have seen, in terms of legislation having failed, 'trial' having led to repeated 'errors', ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster. To stay experimenting in things economically is a grave responsibility, and denial of the right to experiment is fraught with serious consequences for the nation".

It is only fair that the NCLT, for the purpose of passing an order of substantive consolidation or procedural coordination or otherwise, examines whether the contemplated order will commercially or legally prejudice any person. The answer is most likely to weigh in favour of substantive consolidation in an overwhelming number of cases. Even the other group entities with different legal structures will benefit from the order of consolidation as they will be able to address the contractual and other relationship issues with the defaulting company arising from the insolvency resolution process.

We should nevertheless recognize that, despite the absence of a Group Insolvency Framework, NCLT benches have suo motu applied principles of Group Insolvency on a case-by-case basis to better achieve the objectives of the IBC. Illustratively, during the insolvency of Videocon Industries[4], the NCLT, Mumbai, permitted consolidation of the insolvency proceedings of 13 of the 15 entities in the Videocon Group on grounds that the operations of these entities were inextricably linked, and the entities were also involved in availing loan facilities under a composite agreement. Other factors going in favour of consolidation were (i) common control, assets, directors, liabilities; (ii) interdependence of the companies; (iii) interlacing of finance; (iv) pooling of resources; (v) co-existence for survival; (vi) intricate links between the entities; (vii) intertwined accounts; (viii) inter-looping of debts; (ix) singleness of economic activity of units; and (x) common financial creditors.

> **"Hopefully, once the 'enabling' Group Insolvency Framework is introduced the vibrance of the insolvency landscape will be enhanced to the desired levels."**

Subsequently, during the insolvency of Lavasa Corporation[5], the NCLT, Mumbai permitted the consolidation of insolvency proceedings of Lavasa Corporation and its 4 wholly owned subsidiaries, including two subsidiaries that were not undergoing insolvency resolution (subject to the approval of their creditors). The NCLT based its decision on the fact that the debts of all 4 subsidiaries were guaranteed by Lavasa Corporation, and the Resolution Plan was conditional on the consolidation of the insolvency process of all the entities.

3. *Swiss Ribbons & Anr. v. Union of India & Ors,* SC Order dated 25.01.2019.

4. *SBI v. Videocon Industries & Ors,* NCLAT Order 4.7.2019 SCC Online NCLT 745.

5. *Axis Bank & Ors v. Lavassa Corp.* MA 3664 of 2019 in CP 1765-1757&574/2018 26.2.2020

The National Company Law Appellate Tribunal (NCLAT) has also ordered procedural coordination for insolvency proceedings through a single IP before a single AA for 5 entities who jointly owned a plot of land and were operating as a consortium in *Edelweiss Asset Reconstruction Co Ltd v. Sachet Infrastructure Pvt Ltd & Ors*.

5. Conclusion

From the jurisprudence, it is clear that group insolvency is predicated on the insolvent entities being intricately linked and operating as a single economic unit. In addition, the consolidation of insolvency proceedings must be consistent with the objectives of the IBC.

As such, the extant laws and the judicial pronouncements on group entities where the piercing of the corporate veil is of fundamental importance in upholding the objectives of IBC in providing all stakeholders with the best possible outcome, are largely adequate to deal with situations as they arise. Only the judicial infrastructure should have the mindset to take the bull by its horns and deliver robust outcomes. The IBBI on February 04, 2025, has floated a Discussion Paper "Streamlining Processes under the Code: Reforms for Enhanced Efficiency and Outcomes" which also has a proposal on "Coordinated Insolvency Resolution for Interconnected Entities". This is viewed as a significant step towards Group Insolvency Framework under the IBC. Hopefully, once the 'enabling' group insolvency framework is introduced the currently witnessed erosion of confidence in the insolvency framework may be arrested and the vibrance of the insolvency landscape would be enhanced to the desired levels.