Sustainability and IBC: Incorporating ESG Principles in Resolution Plans

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Environmental, Social, and Governance (ESG) is increasingly getting emphasis on global economic scenario. This has necessitated the integration of ESG considerations into insolvency processes to address systemic risks and enhance the long-term sustainability of distressed businesses. With rising environmental and social challenges worldwide, businesses that fail to prioritize ESG issues are prone to risk of being left behind in an increasingly sustainability-focused global economy. In this backdrop, the author has analyzed the importance of a robust ESG framework in resolution of corporate debtors under the Indian insolvency ecosystem. He has mentioned best ESG practices in United States of America (USA), European Union (EU), Brazil, Italy, Canada, Australia etc. to be used as key takeaways for developing and implementing a robust ESG framework under the IBC. ***Read on to know more…***

1. Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) has been pivotal in reforming India's insolvency landscape. While it focuses on timely resolution and value maximization for stakeholders, the increasing global emphasis on sustainability calls for the integration of Environmental, Social, and Governance (ESG) principles within insolvency and restructuring frameworks. Incorporating ESG principles into resolution plans not only aligns insolvency processes with global trends but also ensures the sustainable revival of distressed companies, contributing positively to the broader socio-economic and environmental fabric.

Historically, insolvency and restructuring mechanisms have prioritized creditors' interests, often at the expense of broader stakeholder and societal concerns. However, a paradigm shift is underway, recognizing that companies operate within a larger societal framework and bear responsibilities extending beyond financial metrics. As highlighted in "The Intersection of ESG and Insolvency[1]," the failure to integrate sustainability considerations in Indian insolvency framework risks perpetuating unsustainable practices that harm both economies and ecosystems. The notion that businesses can thrive while ignoring environmental and social externalities is no longer tenable.

The evolving nature of the global economy necessitates that sustainability should not merely be a corporate social responsibility initiative but a core component of economic revival strategies. By embedding ESG principles into the insolvency process, the IBC can facilitate a structural shift towards long-term resilience and sustainable economic growth. This becomes especially relevant as businesses are increasingly evaluated not just on their financial performance but also on their environmental impact, social contributions, and governance structures. Such a transition not only aligns with India's international commitments but also positions its insolvency framework as a benchmark for responsible business practices.

2. ESG Principles: A Foundation for Sustainable Business Practices

ESG represents a framework that evaluates a company's practices and policies regarding environmental stewardship, social responsibility, and corporate governance. The key components include:

a) **Environmental:** Issues like climate change, resource efficiency, carbon emissions, and pollution control are kept under this component. Companies with poor environmental practices often face reputational damage and regulatory penalties, which can be particularly detrimental during insolvency. The lack of environmental compliance can result in legal challenges, complicating the restructuring process further.

b) **Social:** It includes human rights, labor practices, community relations, and customer protection. A socially responsible company ensures fair treatment of workers and contributes positively to its surrounding community. For instance, companies that engage in ethical sourcing and provide safe working conditions tend to have stronger stakeholder support during distress.

c) **Governance:** It includes ethical business practices, regulatory compliance, board diversity, and transparency. Robust governance minimizes fraud, corruption, and mismanagement which are critical factors for rebuilding trust during insolvency. Poor governance practices often contribute to financial distress, making this aspect of ESG indispensable during restructuring.

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Globally, ESG principles are becoming an essential metric for investors, creditors, and regulators, highlighting their relevance in insolvency and restructuring. Evidence suggests that ESG-compliant companies tend to deliver superior financial performance over the long term, are better equipped to manage risks, and are more likely to secure stakeholders' confidence, especially during periods of distress.

3. Relevance of ESG in Insolvency and Restructuring

Integrating ESG considerations into insolvency processes can address systemic risks and enhance the long-term sustainability of distressed businesses. With rising environmental and social challenges worldwide, businesses that fail to prioritize ESG issues risk being left behind in an increasingly sustainability-focused global economy. The following key points highlight the importance of ESG integration in insolvency and restructuring:

a) **Risk Mitigation for Long-Term Stability:** Distressed companies often carry substantial environmental and social risks that can obstruct

[1] The Intersection of ESG and Insolvency" by Sudhaker Shukla and Asit Behera, *Published in IBC Evolution, learnings & Innovation by IBBI, available at: https://ibbi.gov.in/uploads/publication/c9800578f99e42c11b5573b4686fb545.pdf , at Page-142*

successful restructuring. For example, legacy issues like pollution, non-compliance with labor laws, or local community conflicts can result in legal liabilities and resistance from stakeholders. ESG-driven plans ensure these risks are identified, addressed, and mitigated, facilitating a smoother restructuring process and reducing operational disruptions[2].

b) **Strengthening Investor and Creditor Confidence:** Investors and financial institutions increasingly prioritize ESG-compliant companies, recognizing them as lower-risk and higher-value investments. Incorporating ESG principles into resolution plans helps attract investment by aligning businesses with global sustainability standards. As highlighted by Bloomberg (2024)[3], ESG-focused investments expected to hit $40 trillion by 2030 globally, signaling the significance of ESG compliance in business recovery.

c) **Alignment with International Commitments and Legal Obligations:** Incorporating ESG considerations align with international sustainability frameworks like the Paris Climate Accord, the United Nations Sustainable Development Goals (SDGs), and EU Green Deal Policies. Indian businesses integrating ESG practices are better equipped to operate in international markets where sustainability is a critical compliance requirement[4].

d) **Value Creation and Competitive Edge for Creditors:** ESG integration often uncovers new opportunities for operational efficiency, cost savings, and revenue streams, ultimately benefiting creditors. Companies focusing on sustainable practices experience reduced regulatory penalties, improved resource optimization, and enhanced brand equity. For instance, clean energy transitions or eco-friendly processes can lower costs and appeal to environmentally conscious stakeholders (OECD Report, 2024)[5].

e) **Competitive Positioning in Global Trade:** Global markets increasingly emphasize ESG compliance as a standard for trade and investment. Indian businesses integrating ESG into insolvency resolutions will gain a competitive edge by showcasing responsible business practices and aligning with international investor expectations[6].

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ESG integration in insolvency processes offers a future-ready approach, ensuring distressed businesses can recover with sustainability at their core. Countries like the EU, USA, and Brazil have successfully demonstrated how incorporating ESG metrics leads to more resilient and economically viable business outcomes. These best practices of overseas economies could be contextualized and implemented in India.

4. ESG and IBC: Current Landscape in India[7]

Although the IBC does not explicitly mandate ESG considerations, India's regulatory environment reflects an evolving approach toward sustainable practices. The following key developments highlight the progress:

a) SEBI's Business Responsibility and Sustainability Reporting (BRSR): SEBI mandates listed companies to disclose ESG performance across environmental, social, and governance parameters. These disclosures provide transparency into sustainability practices and encourage companies to incorporate ESG risks into their strategic planning. This framework sets benchmarks for corporate sustainability, influencing investor decisions and fostering accountability (*SEBI Circular, 2021*[8]).

2. https://www.unep.org/about-un-environment/why-does-un-environment-matter/environmental-social-and-economic, *UNEP, ESG framework*
3. *https://www.bloomberg.com/company/press/global-esg-assets-predicted-to-hit-40-trillion-by-2030-despite-challenging-environment-forecasts-bloomberg-intelligence/*
4. *Ibid. 2*
5. Global Corporate Sustainability Report 2024, available at: *https://www.oecd.org/en/publications/global-corporate-sustainability-report-2024_8416b635-en.html*
6. *https://tradejini.com/why-esg-matters-for-indian-businesses-and-investors/*
7. Ashwin Bishnoi Khaitan & Co., ESG In Restructuring, *Published by INSOL Internatinal*
8. SEBI Circular, 2021, available at: *https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html*

b) **The Companies Act and Corporate Governance:** India's Companies Act 2013 promotes ethical governance practices, such as appointing independent directors and ensuring compliance with transparency norms. These regulations indirectly advance ESG principles, reinforcing accountability, minimizing mismanagement, and aligning corporate practices with sustainable goals.

c) **Potential Role of the IBBI:** The Insolvency and Bankruptcy Board of India (IBBI) is well-positioned to institutionalize ESG frameworks within insolvency proceedings. While ESG mandates are not yet explicit, the IBBI can issue guidelines requiring resolution applicants to disclose sustainability risks and integrate ESG components into resolution plans. This approach would align India's insolvency framework with international best practices, promoting resilient and responsible corporate recoveries[9].

d) **Judicial Recognition of ESG Principles:** Indian courts have begun recognizing the importance of environmental sustainability during insolvency and restructuring. For example, courts have emphasized the need for companies in environmentally sensitive industries to address pollution liabilities and adopt remediation measures as part of their restructuring plans.

> **Indian courts have begun recognizing the importance of environmental sustainability during insolvency and restructuring.**

e) **Rise of ESG as a Market Driver:** Market forces, including institutional investors and creditors, are increasingly considering ESG compliance into their assessments of distressed companies. A business failing to align with sustainability standards may face challenges securing financing and investor confidence, further emphasizing the need for ESG adoption during insolvency[10].

Together, these developments reflect a growing acknowledgment of ESG as a critical component of corporate governance and restructuring in India. Integrating ESG principles into the IBC will not only enhance business resilience but also align India's insolvency framework with global sustainability imperatives.

5. Global Practices[11]

Countries like the United States and those in the European Union (EU) have made strides in integrating ESG into their insolvency laws:

a) **United States:** ESG factors are considered in Chapter 11 bankruptcy cases, influencing restructuring outcomes. For example, companies in industries like energy are often required to address environmental risks before securing creditor approval. In some cases, resolution plans explicitly incorporate commitments to reduce carbon emissions or transition to renewable energy. Moreover, under environmental laws such as CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act), provisions ensure that environmental cleanup obligations are factored into bankruptcy proceedings. This approach highlights the importance of incorporating ESG-related liabilities into insolvency processes.

b) **European Union:** The EU's Corporate Sustainability Reporting Directive (CSRD) emphasizes the integration of sustainability in corporate practices, including insolvency proceedings. This directive has spurred companies to adopt ESG metrics even in challenging circumstances like restructuring. Additionally, the EU's Green Deal has created financial incentives for businesses to adopt sustainable practices during distress. Regulation No. 2019/2088 (SFDR) also mandates financial market participants to disclose sustainability risks, ensuring accountability in investments and restructuring plans.

9. *Ibid 1*

10. *Ibid 1*

11. Sustainability in Insolvency and Restructuring Procedures, by Carlo Ghia, Thiago Braga Junqueira, Mariam Zaidi, and Gabriel Olivera, *Published by UN under Sustainable development Goals, Available at: https://www.iiiglobal.org/file.cfm/156/docs/sustainability%20in%20insolvency%20and%20restructuring%20procedures.pdf*

c) **Italy:** Italy's Corporate Crisis and Insolvency Code (CCII) incorporates early warning tools and provisions for restructuring agreements that account for ESG considerations. Article 87 of the CCII specifically mandates that restructuring plans must account for safety and environmental protection costs, signaling a shift towards more inclusive frameworks.

d) **Brazil:** Brazil's insolvency regime demonstrates the critical role ESG plays in restructuring. The Samarco case, involving a major environmental disaster, illustrates how judicial reorganization plans can prioritize environmental remediation while ensuring business continuity. Similar cases emphasize the inclusion of social commitments as part of restructuring agreements.

e) **Australia and Canada:** Shareholder activism in these regions has encouraged the inclusion of ESG considerations in corporate governance and insolvency practices, setting valuable precedents for India to emulate. Australian laws, for example, often require detailed reporting on environmental impact during restructuring, promoting transparency and accountability.

India can adopt similar measures to promote ESG compliance, making its insolvency framework more globally competitive and sustainable. By integrating international best practices, India can improve the efficiency and outcomes of its insolvency processes while enhancing its global standing as a sustainable business hub.

6. Challenges in Integrating ESG within IBC

Despite the advantages, integrating ESG principles into the IBC framework is fraught with challenges:

a) **Cost Implications:** Evaluating and implementing ESG measures may increase the cost and complexity of resolution plans. Smaller companies in distress may find it challenging to bear these additional costs without financial support. ESG audits and compliance monitoring add to the financial burden, making it necessary to incentivize ESG adoption for smaller businesses. Additionally, companies with limited resources may struggle to prioritize ESG measures while addressing immediate financial obligations.

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b) **Lack of Awareness:** Limited understanding of ESG among insolvency professionals and creditors can impede its adoption. Comprehensive training programs are essential to bridge this gap. Additionally, many stakeholders view ESG as a secondary consideration, focusing instead on immediate financial recovery. Raising awareness about how ESG principles align with financial viability can help overcome these misconceptions and promote acceptance among stakeholders.

c) **Quantification Issues:** Measuring and enforcing ESG commitments post-resolution remains a challenge. Lack of standardized ESG metrics can create discrepancies in implementation. The absence of clear benchmarks makes it difficult to assess whether companies are meeting their ESG goals. Developing sector-specific ESG criteria and frameworks can ensure consistent monitoring and reporting, addressing this issue.

d) **Resistance to Change:** Stakeholders might resist ESG integration due to its perceived impact on immediate value recovery. Educating stakeholders about the long-term benefits of ESG is critical. Resistance is often rooted in misconceptions about ESG being incompatible with financial goals. A collaborative effort involving regulators, creditors, and professionals can help demonstrate the synergies between ESG adoption and economic revival, fostering stakeholder confidence.

Addressing these challenges requires a collaborative approach involving regulators, professionals, and creditors. Incentivizing ESG adoption and providing technical support can mitigate some of these barriers.

Additionally, introducing policy frameworks that mandate ESG integration and aligning incentives for compliance will encourage wider adoption within the insolvency ecosystem.

7. Recommendations for ESG Integration

To effectively incorporate ESG principles into the IBC framework, the following steps are recommended:

a) **Policy Framework:** Introduce ESG guidelines under the IBC, mandating their inclusion in resolution plans. Such guidelines could provide clarity on expectations and facilitate standardized practices. Policymakers can draw from international frameworks like the EU's CSRD to design robust ESG regulations. This approach would ensure that resolution professionals have a clear understanding of the required ESG benchmarks, minimizing ambiguity and encouraging structured implementation.

b) **Capacity Building:** Train insolvency professionals and resolution applicants on ESG evaluation and compliance. This training should include practical tools and case studies to make ESG integration actionable. Professional certification programs can also enhance awareness and expertise. Additionally, continuous learning opportunities, such as workshops and seminars, can help professionals stay updated with global ESG trends and frameworks.

c) **Incentivization:** Provide financial or regulatory benefits to resolution plans that prioritize ESG adherence. For instance, reduced regulatory scrutiny or tax benefits could incentivize compliance. Financial institutions could also offer preferential lending rates to ESG-compliant businesses. Creating government-backed ESG funds to support distressed companies in adopting sustainability measures can further encourage adoption among smaller businesses.

d) **Monitoring Mechanisms:** Establish systems to track ESG compliance post-resolution, ensuring adherence to commitments. Regular audits and public disclosure can reinforce accountability. Advanced technologies like blockchain can be used to create transparent and immutable records of ESG performance. Leveraging digital tools can simplify monitoring and reporting processes, reducing administrative burdens for companies.

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e) **Stakeholder Collaboration:** Foster collaboration between regulators, creditors, and professionals to build consensus on ESG integration. Collaborative approaches can minimize resistance and enhance adoption rates. Creating a multi-stakeholder task force to oversee ESG integration could be a viable strategy. Engaging industry experts and civil society organizations can further strengthen the credibility and success of ESG initiatives.

8. Benefits of ESG Integration in Insolvency

The incorporation of ESG principles into insolvency frameworks brings multifaceted benefits that extend beyond financial recovery. Key advantages include:

a) **Long-term Viability:** Businesses aligned with ESG principles demonstrate greater resilience to market fluctuations and environmental disruptions. Studies by the United Nations Environment Programme (2022) indicate that ESG-compliant companies are better prepared to mitigate risks such as climate change, resource scarcity, and regulatory pressure. This long-term stability ensures businesses recover sustainably while enhancing their competitiveness.

b) **Enhanced Reputation and Stakeholder Trust:** ESG compliance fosters a strong reputation by demonstrating a commitment to ethical business practices, environmental protection, and social responsibility. Companies adhering to ESG principles often experience improved stakeholder trust, which translates into stronger relationships with investors, employees, customers, and regulatory authorities. A Harvard Business Review report (2021) highlighted those businesses focusing on sustainability experienced a 20% increase in customer loyalty and brand value.

c) **Attracting Global Investments:** ESG-compliant businesses are increasingly favored by institutional investors and global markets. Investment funds, such as ESG-specific green bonds, prioritize companies meeting sustainability benchmarks. According to a report by MSCI (2022)[12], ESG-driven investments have outperformed traditional investment portfolios, indicating that sustainability can serve as a driver for financial recovery and improved market access.

d) **Regulatory and International Alignment:** Integrating ESG into insolvency processes aligns India's corporate restructuring frameworks with international sustainability standards, such as the EU Taxonomy for Sustainable Activities and the UN's SDGs. This alignment not only enhances India's competitiveness in global trade but also facilitates smoother cross-border insolvency resolutions. Regulatory authorities worldwide increasingly emphasize ESG disclosures, making compliance a necessity for Indian businesses seeking international investment, said *OECD Report, 2023*[13].

e) **Cost Savings and Operational Efficiencies:** ESG principles promote resource efficiency, energy savings, and waste reduction thereby lowering operational costs during and after insolvency proceedings. Businesses transitioning to renewable energy or adopting circular economy practices often achieve significant long-term cost advantages while mitigating environmental liabilities.

f) **Improved Credit Access and Market Positioning:** Financial institutions and creditors are more likely to extend credit to businesses that demonstrate strong ESG compliance. Companies integrating ESG principles into their resolution plans reduce perceived risks for creditors, improving their creditworthiness and access to financing[14].

> **Integration of ESG into resolution plans under the IBC represents a significant opportunity to align Indian insolvency ecosystem with SDGs.**

9. Conclusion

The integration of ESG principles into resolution plans under the IBC represents a significant opportunity to align India's insolvency framework with sustainable development goals. While challenges persist, proactive measures by regulators, professionals, and creditors can pave the way for a more resilient insolvency ecosystem. By embedding sustainability into the heart of corporate restructuring, India can ensure that distressed businesses emerge stronger, contributing positively to the economy, society, and environment.

As India aspires to position itself as a global leader in sustainable business practices, incorporating ESG into insolvency processes can serve as a crucial milestone. The alignment of economic revival with sustainability principles will not only secure financial stability but also safeguard the interests of future generations.

12. *https://www.msci.com/www/blog-posts/esg-factor-returns-2022-in/03701563813*

13. *https://www.oecd.org/content/dam/oecd/en/publications/reports/2022/01/trends-in-esg-investing-and-quality-infrastructure-investment-in-asia-pacific_022d1fc8/86d154c1-en.pdf,* page 43

14. *Ibid 3*