Mediation in Insolvency: A New Paradigm for Resolution under the IBC

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Mediation is emerging as a promising mechanism for dispute resolution in India, receiving significant impetus with the enactment of the Mediation Act, 2023. However, the absence of a structured framework for applying mediation to disputes arising during the insolvency process under the Insolvency and Bankruptcy Code (IBC) or prior to the admission of a Corporate Insolvency Resolution Process (CIRP) application remains a major gap. Drawing on the provisions of the Mediation Act, 2023 and the recommendations of the IBBI Expert Committee's January 2024 report, this article explores the potential integration of mediation within India's insolvency framework. It advocates a phased introduction of mediation to address procedural bottlenecks and promote a "rescue culture," enabling to achieve amicable settlements at early stages, thereby reducing judicial dependence and enhancing the overall efficiency of the insolvency process. ***Read on to know more…***

1. Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) establishes a comprehensive legal framework for the resolution and liquidation of companies, firms, and individuals facing insolvency. The primary objective of the IBC is to provide a mechanism for the resolution of insolvent entities, with these insolvency proceedings being overseen by the National Company Law Tribunal (NCLT).

However, NCLT Benches are currently overwhelmed with an increasing number of Corporate Insolvency Resolution Process (CIRP) applications, which include those involving corporate debtors and personal guarantors. Not all these cases, however, require judicial intervention; many could be resolved through out-of-court settlements or alternative dispute resolution mechanisms. While mediation has been occasionally used in the context of the IBC, the Code lacks a clear, dedicated provision for using mediation as a formal dispute resolution tool in insolvency cases.

Mediation is a type of Alternative Dispute Resolution (ADR) where a neutral third party helps the disputing parties resolve their issues. The mediator does not impose a decision but instead facilitates discussions to guide the parties toward a mutually agreeable settlement.

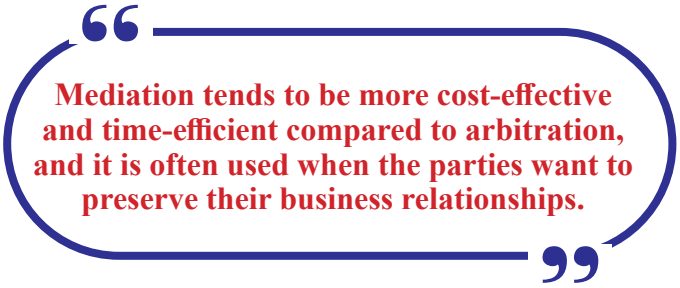
2. Distinction between Arbitration and Mediation

Both arbitration and mediation are ADR processes designed to resolve disputes outside the judicial system. However, they differ significantly in their procedures and outcomes:

(a) Arbitration is a more formal process in which the arbitrator makes a final decision on the dispute, similar to a court ruling. The arbitral award is binding and enforceable.

(b) Mediation, on the other hand, is less formal. In this process, the mediator assists the parties in negotiating a settlement. The mediator does not have the authority to make decisions for the parties, and the outcome is only binding if both parties voluntarily agree to the settlement terms.

Mediation tends to be more cost-effective and time-efficient compared to arbitration, and it is often used when the parties want to preserve their business relationships. By emphasizing cooperation rather than conflict, mediation can be particularly beneficial in situations where ongoing relationships are important.



3. Mediation under the IBC process

The Mediation Act 2023 defines Mediation[1] as:

"Mediation" refers to a process—whether termed as mediation, pre-litigation mediation, online mediation, community mediation, conciliation, or any similar expression—through which parties seek to amicably resolve their dispute with the help of a neutral third party, known as a mediator. The mediator facilitates discussions but lacks the authority to impose a binding resolution on the disputing parties.

Mediation proceedings are distinct for their voluntary nature and lead to a binding outcome when the disputing parties, aided by a neutral third-party mediator, collaborate to reach a mutually agreed-upon settlement.

The Insolvency and Bankruptcy Board of India (IBBI) established an expert committee[2] (Committee) tasked with submitting a report on the use of mediation within the framework of the IBC. The Committee submitted its report titled "Framework for the Use of Mediation in the Insolvency and Bankruptcy Code, 2016" in January 2024. In this report, the Committee explores the role of mediation in insolvency proceedings in jurisdictions such as the USA, Singapore, UK, and China. It also emphasizes the benefits that India could reap by ratifying the Singapore Convention on Mediation, which would offer a more streamlined process for the enforcement of mediated settlement agreements.

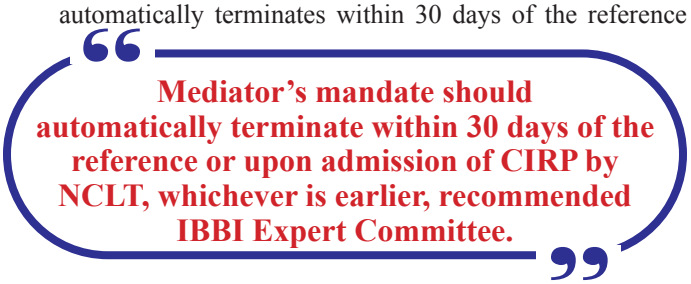
The Committee highlighted that mediation has already found a place in the Indian legal system, with the Mediation Act, 2023 strengthening its foundation. However, it also noted that IBC does not currently mandate the use of mediation in its proceedings. The Committee identified two primary models for insolvency mediation in India:

(i) Voluntary and Consensual Reference to Mediation: In this model, courts refer disputes to mediation only with the consent of the parties involved.

(ii) Mandatory Mediation: This model requires parties to attempt mediation before initiating legal proceedings or filing suits.

The Committee concluded that while the Mediation Act, 2023 is a significant step forward for mediation, it cannot be directly applied to IBC proceedings. Instead, a specially tailored mechanism would need to be developed to align with the unique characteristics of the insolvency regime in India. The report mentions that mediation can be used to resolve disputes and facilitate consensus among stakeholders at various stages of CIRP and has also provided recommendations on how mediation can ideally be integrated along every phase of CIRP. It suggests that mediation can serve as an effective dispute resolution mechanism at various stages of the CIRP. The Committee has outlined distinct phases where mediation could be appropriately integrated:

(a) Pre-Commencement Stage: At this stage, mediation should be governed by the Mediation Act, 2023, as the framework of the IBC is activated only upon initiation of CIRP. The Committee recommends that the NCLT provide credit ors the option to offer mediation to resolve disputes. Mediation may also be initiated by mutual consent of parties, with specific intimation to the NCLT. A provision should be introduced to ensure that the mediator's mandate automatically terminates within 30 days of the reference or upon admission of the CIRP by the NCLT, whichever occurs earlier.



1. The Mediation Act 2023. (https://legalaffairs.gov.in/sites/default/files/MediationAct2023.pdf)

2. Report of the expert committee on "Framework for use of Mediation in Insolvency and Bankruptcy Code 2016" dated January 31, 2024. (https://ibbi.gov.in/uploads/ whatsnew/1256aa8a9e2c89bd09d8186dae2e6019.pdf)

(b) Post-Commencement Stage: A cautious approach is required for referring disputes to mediation during the CIRP. The Committee has identified several scenarios where mediation may prove beneficial, such as:

(i) Handover of control of the Corporate Debtor and related information required by the Resolution Professional (RP).

(ii) Disputes among creditors at the level of the Committee of Creditors (CoC).

(iii) Interlocutory Applications.

(iv) Ownership disputes concerning assets; and

(v) Avoidance proceedings.

The Committee emphasized that mediation for such matters should be voluntary, time-bound, and conducted parallel to statutory timelines under the IBC, ensuring it does not impair the rights of third parties or undermine the commercial wisdom of the CoC. Mediated Settlement Agreements (MSAs) reached during CIRP should be confirmed by the NCLT. To ensure transparency and due process, the salient features of the MSA should be disclosed to the public and stakeholders before NCLT's confirmation.

(c) Resolution Plan Stage:

During the resolution plan approval stage, mediation may be used to build consensus among stakeholders, reduce resistance on matters that lend themselves to amicable settlement., and foster cordial relations with existing stakeholders. However, recognizing the complexity arising from the involvement of multiple parties, the Committee recommends that NCLTs offer parties the option to resolve disputes via mediation, with referrals made only upon the consent of all parties, if deemed fit by the NCLT.

(d) Implementation of Resolution Plan Stage

In cases where disputes or issues arise during the implementation of the approved Resolution Plan by the Successful Resolution Applicant (SRA), the Committee recommends that mediation should be pursued before approaching the NCLT. It further suggests that a mediation clause of this nature may be incorporated into the Resolution Plan at the time of its finalization, if deemed appropriate.

(e) Liquidation Stage

The Committee noted that mediation's utility at the liquidation stage is minimal, as most disputes would have been adjudicated by this point. It observed that introducing mediation at this stage may cause further erosion in the enterprise's value and impede the Code's objective of value maximization. Consequently, the Committee recommended that mediation at the liquidation stage should not be introduced during the initial phase of implementation.

4. Mediation in Individual Insolvency

The individual insolvencies seem to be the best cases for mediation. Sections 94 to 120 of the IBC govern the insolvency resolution process of individuals. For the first phase of implementing insolvency mediation, these proceedings are also appropriate cases where voluntary mediation may be considered prior to admission, but after submission of the Resolution Professional's (RP's) report. The Supreme Court of India has held that the RP's report is a facilitative fact collection process, after submission of which the adjudicatory process begins. Once the report has been filed under Section 99 of the IBC, the parties are amenable to settle the matter out of court within the statutory timelines under Part III of the IBC.

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The Committee is of the considered view that, at present, it would be appropriate to introduce mediation in the insolvency resolution process for individuals. In these, the personal element of 'debtor' is involved and helps to bring in individual decision making to the table leading to efficient resolution. Further, there are a low number of other stakeholders involved and the capacity of the individual to take decisions is largely independent, which presents a high likelihood of mediation being successful in cases of individual insolvency.

With respect to the framework for implementing mediation in individual insolvency cases, the Committee recommends that, in the first phase, mediation be made voluntary at both the pre-institution and post-filing stages. Such mediation may be conducted parallel to the procedure established under the Code by a skilled mediator, particularly in matters involving technical issues or resolution of personal estate disputes.

4.1. Recommendations of Committee for Insolvency Mediation Framework under the IBC:

The Committee recommended introduction of mediation as a method to resolve disputes relating to arbitration in a cost effective and timely manner in alignment with objectives of the IBC. It suggests implementing mediation in a phased manner, starting with voluntary mediation, and incorporating feedback and learnings from the process.

The Committee identified and recommended four key factors for designing and using mediation under IBC:

(a) the possibility and effectiveness of mediation at different stages of insolvency resolution,

(b) the impact on the statutory timelines under the Code,

(c) the possibility of parallel mediation and insolvency proceedings, and

(d) the impact on third party rights and due process.

5. Qualifications and Experience of the Mediators

The Mediation Act 2023 defines Mediator as follows:

A "mediator" refers to an individual appointed—either by the parties involved or by a mediation service provider—to conduct the mediation process, and also includes any person registered as a mediator with the Council.

Chapter IV of the Mediation Act 2023 deals with provisions relating to appointment of the Mediators. Qualified and experienced mediators are crucial for effective resolution of insolvency-related disputes, as they help cultivate a rescue mechanism that builds trust among the disputing parties, stakeholders, and judicial authorities. To maintain public confidence in the mediation framework, mediators must uphold strict ethical standards and promote transparency while embodying the "4Cs"—control, certainty, confidentiality, and closure. A robust ADR mechanism must incorporate safeguards against corruption and enforce ethical guidelines to protect existing legal values and principles.

In India, disputes under the IBC often involve technical and complex issues. The Committee recommends expanding the mediator pool to include:

(a) retired judges or members of the NCLT and NCLAT.

(b) senior advocates or legal practitioners with a track record of at least ten (10) successful insolvency cases.

(c) former senior officials from financial regulatory bodies like the IBBI or senior officers from scheduled commercial banks; and

(d) Insolvency Professionals with a minimum of ten (10) years' experience.

The Committee further suggests establishing a Code of Ethics for Mediators, setting forth minimum professional standards that mediators must comply with. This Code of Ethics will regulate mediators' conduct and ensure that their duties are carried out in alignment with high standards of professional ethics.

6. Conclusion

Under the insolvency framework in several foreign jurisdictions, court-driven processes are typically invoked only after all alternative dispute resolution mechanisms—such as mediation, negotiation, and arbitration—have been exhausted. However, this

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practice is not yet embedded within the IBC regime. Under the current framework of the IBC, there is no structured requirement to explore alternative dispute resolution prior to initiating formal insolvency proceedings.

To address existing bottlenecks and improve the efficacy of the insolvency process, mediation should be introduced in a phased, stage-based manner within the IBC regime. The insolvency mediation framework should not merely be perceived as a supplemental dispute resolution mechanism but rather as a strategic tool for cultivating a new "rescue culture." This culture would provide debtors and creditors with a structured opportunity to amicably resolve disputes at the earliest possible stage—preferably without the need for intervention by the NCLT.

Even after the commencement of insolvency proceedings, mediation should be encouraged at various stages, carefully aligned with the statutory timelines of the IBC. This would allow for disputes to be addressed expeditiously and amicably, reducing the burden on adjudicatory authorities and facilitating quicker resolutions.

This paradigm shift toward a rescue culture would emphasize the empowerment and autonomy of various stakeholders. Presently, much of this control is exercised by the NCLTs. By introducing mediation as a core component of the insolvency framework, the process can evolve toward a more collaborative and efficient system, enhancing outcomes for all stakeholders involved.