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Azadi Ka Amrit Mahotsav

अनुसंधान

Exploring New Perspectives on Insolvency

ABOUT THE PUBLICATION

This publication presents a compact collection of critical research areas in the insolvency and bankruptcy space. It brings together the deliberations of the two-day International Conference on Insolvency and Bankruptcy organised by IBBI in association with IIM Ahmedabad at the IIM Ahmedabad campus on April 30 and May 1, 2022. It presents answers to some of the key questions and emerging frontiers regarding the Insolvency and Bankruptcy Code, 2016. It presents insights, bringing clarity and reason to what is known and offers ideas on how to explore further into what yet remains the unknown. It is a succinct compendium of thought-provoking research papers in the fledgling insolvency and bankruptcy space. With 26 papers, set in four sections, the book comes as good read for readers with an interest to know the latest developments and as a handy reference text for scholars on what needs further exploration.

This book is published by the Insolvency and Bankruptcy Board of India and is released on the occasion of the Azadi ka Amrit Mahotsav celebrations to commemorate the path breaking economic reform, the Insolvency and Bankruptcy Code, 2016.

अनुसंधान

Exploring New Perspectives on Insolvency

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FOREWORD

Evidence-based policy making is at the heart of being a reformist government. It is as important that we have a rigorous, evidence-based approach to public policy in India today as at any time in our history. Without evidence, policy makers must fall back on intuition, ideology, or conventional wisdom — or, at best, theory alone. Among other things, policies that haven't been informed by good evidence and analysis fall prey to the '*Law of Unintended Consequences*' — in popular parlance, ***Murphy's Law*** — which can lead to costly mistakes.

The concept of evidence-based policy making is not a novel concept. Its absence in practice, however, has been long lamented. Over a century ago, for example, **Florence Nightingale** admonished the English Parliament in the following terms:

> ***'You change your laws so fast and without inquiring after results past or present that it is all experiment, seesaw, doctrinaire; a shuttlecock between battledores.'***

Evidence-based policy making is by no means new to India. For example, one of the key economic policy reforms that drew heavily on evidence-based reviews/evaluations was **RBI's switch to flexible inflation targeting.** The idea of flexible inflation targeting emerged sometime back in 2013 and over the next three years, the RBI set about preparing the pre-conditions for the regime shift, learning from country experience, cherry picking the best practices from what worked and where. The novelty in the RBI's approach under this policy was lower responsiveness than before to actual movements in inflation, suggesting forward-looking behaviour which enhanced policy credibility – smaller changes in the policy rate are now needed to signal the central bank's intent.

The Insolvency and Bankruptcy Board, 2016 (IBC/Code) is another such economic legislation whose origins lay in sound research and evidence as put together by the Bankruptcy Law Reforms Committee in its Report. The IBC has since then evolved through various amendments that responded to evidence from the ground. The Code has put in place a comprehensive 'one stop shop solution' for resolving insolvency of corporate business. The contribution of this market reform legislation has been profound and felt across the business environment. The strength of this law is reflected not only in the fact that it has time and again withstood judicial scrutiny but also that it has stood the economy in good stead through the tougher slopes of a business cycle. The Code in just over six years of its enactment has strengthened the rights of creditors and offered certainty; reinforced the confidence of investors in the reform process with hopes of second chances for failing ventures.

To bridge the gap between theory and practice, it is important to analyze the practical cases and examine the need to make changes in theory. In an evolving area of insolvency and bankruptcy, there is a need to analyse literature and market information to inform future policy making. Research plays a great part in this. The practices in jurisdictions across the world further help to understand the situation and to build best practices under the law. Evidentiary or research-based foundations for policy making, devoid of discretion, foster transparency and help in bringing complete harmony between policy initiatives and market expectations.

Data invariably plays an essential part of research. It helps examine the issue in an objective manner and test the solution's impact. Efficient policies can be formulated when the data is analysed in combination with theoretical frameworks. The Insolvency and Bankruptcy Board of India (IBBI) publishes data in its Quarterly Newsletters, Annual Reports, and Information Brochures with respect to processes under the Code viz., CIRP, liquidation, voluntary liquidation, individual insolvency, and financial service providers. It consistently posts information pertaining to orders issued by Tribunals and Courts, and the details of insolvency professionals, Insolvency Professional Agencies, Information Utilities, Insolvency Professional Entities, Registered Valuers, and Registered Valuer Organisations. It constituted a research guidance group that has broadened the scope of data dissemination and research themes. In addition, the IBBI has signed several MoUs with research wings of leading institutions. The IBBI has been at the forefront of promoting research in the insolvency and bankruptcy space by building internal and external expertise.

The international research conference on insolvency and bankruptcy is a product of the continued efforts, enthusiasm, and interest of young minds and experts in the field of insolvency and bankruptcy. It provided an excellent platform for all participants to get exposed to the latest studies, evaluation techniques, and emerging ideas in the field. The panel discussions provided a way of getting face-to-face interactions with leaders in the field. It was a learning experience for those just starting their careers in various professions, to gain valuable advice and mentoring. Additionally, a way to start collaborations on papers or projects that would investigate the progress and challenges of the Code and its institutions. This conference has offered insights into the insolvency regime in India and has paved the way to support future policy.

Ravi Mital
Chairperson
Insolvency and Bankruptcy Board of India

PREFACE

Economic freedom and economic growth have a very high positive correlation as entrepreneurial risk-taking ability converges with innovations to provide '***Pareto Optimal***' market based solutions with minimum transaction cost. Countries having a high level of economic freedom, riding on efficacy of '***invisible hand***' generally outperform the countries with not-so-high level of economic freedom. It has, therefore, been the endeavour of countries all over the world to provide the right institutional milieu and policy initiatives that promote and protect economic freedom, and regulate such freedom only to the extent it is necessary for addressing market failure(s).

Business regulations are an essential pre-requisite in an economy as they lay the contour for organised economic activity and also puts in place the incentive-disincentive framework for responsible operation of businesses. The ambit of business regulations covers a business through its entire life cycle i.e., starting a business, running/managing a business, and shutting down a business. This gamut also includes the need for economic legislations that establish a free market environment. This includes the competition act which enables free and fair competition and curbs anti-trust opportunistic behaviour and legislations enabling entrepreneurial development such as the statutes that promote MSMEs and startups.

In designing such business regulations in the context of 'living law, such as Insolvency and Bankruptcy Board, 2016 (IBC/Code), policymakers often rely on a blend of ground realities and research expertise to formulate policy decisions. What seems like the obvious course of policy action, is often just the surface. Beneath it lies deep research of texts, data, and experiences of other experts. New laws and institutions are products of this policy discourse rooted in evidence-based research. Such research is particularly important in the time of dynamic and interrelated challenges that policymakers face in an economy. Public policies guide the macroeconomic and microeconomic management of a nation. Experimentation with the economic law is invariably guided by research and analysis that is achieved through deliberations and careful study of market response, international experiences, and future possibilities. To get the market sentiments right, research in the domain of insolvency and bankruptcy ought to be a precursor to policy change and governance of the Code.

There is a growing research interest among experts in the insolvency and bankruptcy space. Numerous publications in the form of journals, articles, and books, have renewed the once limited interest in studying this very important legislation. The International Research Conference on Insolvency and Bankruptcy organised jointly by the Insolvency and Bankruptcy Board of India and IIM Ahmedabad (IIMA), on April 30 and May 1, 2022, at IIMA campus focused on advancing vital research on the IBC and its institutions from a multidisciplinary perspective. The conference was a meeting ground for experts and young minds determined to answer some of the most pressing questions on the legislation and the institutions established by it. Insightful speeches by the honorable guests set the tone for the first international research conference on insolvency and bankruptcy. The conference witnessed a series of panel discussions by India's thought leaders and policymakers. The panels focused on diverse but interrelated themes of banking and industry, resolutions in insolvency and bankruptcy, and reforms for the future.

The conference received an overwhelming response from the start. Out of 68 research papers received, a total of 39 papers were shortlisted for presentation at the conference. The presentations engaged the finest minds in the field of banking, industry, law, economics, and management from India and abroad, discussing a wide range of contemporary and emerging issues in the insolvency and bankruptcy space.

International experience was shared and discussed by scholars from the United Kingdom, United States, Mauritius, and Argentina. The papers held the audience's interest, enthusiasm, and participation. The question-and-answer sessions by the panel members and the audience enriched the knowledge shared in the papers. Of the presented papers, 26 papers are a part of this publication.

The research papers provided strong evidence for the achievements of IBC. Robust econometric models were used in these papers to study the IBC and its outcomes. Studies provide meaningful insight into how the Code has affected the economic and financial ecosystem of India. Findings suggest that the Code has lubricated the credit channels, and incentivised greater flow of credit to firms under financial stress. The pre and post IBC analysis has also found that policy action of the Code and the institutional mechanism that it has set up has helped reduce the risk of default. While there is large evidence to support the objectives of the Code for firms under financial stress, there is also evidence that post IBC, financial resilience has been strengthened. There is supporting evidence that IBC moderates the negative impact on non-bankrupt firms in the industry during bankruptcy waves in the economy.

Research studies that explored various provisions of the Code have collated large evidence using case laws on the developments and areas of concern under the Code. Studies have suggested a wider approach to enhance the scope of the Code. Conceptual frameworks that analyse the fairness and equity trade off under the Code have also received attention. In addition, there has been emphasis on how IBC is not a standalone law, with papers attempting to examine parallel legislations and its interaction with IBC. Research on the recently introduced pre-packaged insolvency resolution process has also gained traction in this conference as studies focused on factors that affect the pre-pack regime and suggested ways to increase the efficiency of the same.

Amidst the emerging themes and challenges, many studies explored cross-border insolvency regimes, interim finance, and the use of mediation. Studies have examined the choice India must make between universalism and territorialism. They argue that while the UNCITRAL Model Law is a starting point, and India must mould it according to its concerns. There was also a large consensus on the need for interim finance and the critical role it plays in the rescue of the corporate debtor (CD) and ensuring the sale of a CD as going concern. Analysis of the interim finance ecosystem as a supporting tool for IBC suggested that giving it higher priority and ensuring greater regulatory oversight on the committee of creditors can remove roadblocks to interim finance. Both Indian and international presenters have recognised the growing need to use mediation as a tool in the insolvency resolution process. The studies reason that mediation can help arrive at negotiation in a more amicable manner and some ways reduce delays in the insolvency resolution process.

No legislation is free of the reforms it will have to undergo in the future. These reforms can be ex-post in nature, i.e., the reforms that follow an incident. However, there can also be reforms that are ex-ante or pre-emptive in nature. These ex-ante measures are focused on strengthening the Code and preparing it to address the challenges early on. Towards this, aspects focused on predicting bankruptcy and safeguarding the environment were also discussed. Some studies have highlighted the different models that can be used to predict bankruptcy. The researchers emphasised the use of statistical models and the use of artificial intelligence. On the environmental front, researchers have argued that going forward, India will need to develop a climate-sensitive insolvency framework and promote a green IBC.

Research does not speak for itself; policymakers and practitioners must always interpret its meaning and implications for their problems and circumstances and decipher the advance signals for appropriate response. Policymakers and practitioners use research in various ways, including instrumental, conceptual, political, imposed, and the process uses. Increased knowledge of these nuances should enable researchers to produce more useful work and better engage with policymakers, practitioners, and intermediaries. The International Research Conference on Insolvency and Bankruptcy helped develop a critical set of perspectives and insights on the past, present, and future of the insolvency and bankruptcy ecosystem in India. It provided a platform for building a network of researchers and knowledge sharing.

We are indeed grateful to all the professionals, carrying the wealth of experience and expertise, the young minds who will drive future research, for their invaluable contributions through presentations and participation at this conference. We are hopeful that the enthusiasm and research rigor developed through this conference in the insolvency and bankruptcy space will promote more opportunities for and interest in research on insolvency in the future.

Sudhaker Shukla
Whole-time Member
Insolvency and Bankruptcy Board of India

First International Research Conference on Insolvency and Bankruptcy
on April 30 and May 1, 2022 at IIM Ahmedabad


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1

SITUATING MEDIATION WITHIN INDIA'S INSOLVENCY FRAMEWORK:

AN INNOVATIVE AND EFFICIENT INTERVENTION

— *Aakriti Anurag Tewari*

Executive Summary

This research paper recommends the inclusion of mediation within the Indian insolvency framework. Its primary mechanism of doing so is by analysing how mediation has been utilised in the insolvency resolution process of other international jurisdictions and arguing for the inclusion of mediation on this basis. It supplements this exploration with an in-depth cost-benefit analysis of mediation as a facilitative process of commercial dispute resolution.

Furthermore, it analyses the feasibility of situating mediation within the corporate insolvency resolution process (CIRP) in India by performing an in-depth study into potential roadblocks that mediation may face, if attempts are made to include it within the CIRP. In doing so, it draws from jurisprudence from courts as to the inability to refer matters *in rem* to ADR mechanisms, which stands as the primary deterrent to the inclusion of the same in India. However, it attempts to draw from mediation's multiple successes in the Indian jurisdiction outside of the ambit of insolvency to bifurcate such challenges and recommend that mediation would have great value if included within the insolvency process, particularly in light of its various successes in the international insolvency arena.

Finally, this research paper puts forth a two-fold solution as to the inclusion of mediation within the Indian insolvency model. Firstly, the inclusion of multi-party mediation within section 12A of the Insolvency and Bankruptcy Code, 2016 (Code / IBC) is recommended, owing to it being an ideal procedural time wherein the parties are primed to negotiate a settlement. Moreover, it argued that the balance of power between the promoters, directors, and committee of creditors (CoC) would make it a particularly opportune time to seek the inclusion of mediation. Secondly, it is recommended that mandatory mediation prior to the submission of the application under section 7 of the Code be enforced, especially owing to issues such as overburdening of Courts, and the efficient resolution of insolvency disputes even prior to initiation of the CIRP.

Keywords: Insolvency Law, Insolvency and Bankruptcy, International Insolvency, Alternate Dispute Resolution, Corporate Insolvency Resolution Process, Insolvency and Bankruptcy Code, IBC Reform

INTRODUCTION

Indian insolvency law, since the inception of the Code, has seen a surge of watershed reforms that have transformed the Indian insolvency resolution mechanism. At its most basic, the insolvency process represents an inability of the debtor to pay back what is owed to him by the creditor. From the onset of this process, creditors enter into a state of competition amongst themselves to compete for the assets of the debtor, which are liquidated to adequately compensate for the owed amount. Very rarely is this mechanism broadly sufficient to pay off all creditors adequately. Essentially, the interests of the stakeholders are very seldom satisfactorily met over the course of an insolvency proceeding. One of the most significant and positive interventions to address this issue has been the IBC's incorporation within Indian statutes, revolutionising India's approach to insolvency law.

The IBC was introduced in 2016, as primarily an exercise of consolidation. While India's insolvency process was outlined throughout various statutes prior to 2016, the Code served as a means by which one primary statute addressed Indian corporate insolvency under a single umbrella legislation.[1] By keeping separate and divided the commercial and judicial pillars of the process, the Code has further endeavoured to make corporate insolvency a more efficiently handled issue, and exacerbated India's ease of doing business. Its primary objectives, additionally, revolve around balancing the interests of stakeholders in a manner that does not necessarily favour one party, but ensures that the dynamics between debtors and creditors are taken into account.[2] In other words, the debtors, or the company's shareholders and managers are prioritised to ensure that credit may be enjoyed and utilised fruitfully, while the Code simultaneously ensures a balance with the interests of the creditors, to safeguard possible losses in case of default on the part of the debtors.

Other considerations include time-bound resolution of the process within 180 days, promoting entrepreneurship and the availability of credit, and to provide a conclusive solution to India's predicament of non-performing assets (NPAs) or 'bad debt'.[3] The Code has largely been successful in the resolution of these complex and layered conundrums, providing a significant upgrade from its inception to India's approach to insolvency law. The Code's burden has not simply been limited to fulfilling an abundance of ambitious and honourable goals but has further brought a re-evaluation of India's attitude towards insolvency and potential recovery from it. While the Indian business climate had largely tip-toed around insolvency and the possibility of being unable to pay back debt prior to the introduction of the IBC, legal reform has paved the way for companies to explore the possibility of moving past insolvency and making the process as painless as possible for all stakeholders involved.

Though the Code's successes cannot be understated, its fairly recent application has brought with it certain gaps between theory and practice that are imperative to be examined by legal scholars, policymakers, and practitioners. While the IBC has undeniably introduced a time-bound, more efficient process to adjudicate insolvency disputes in a manner that promotes entrepreneurship and fairly compensates creditors, backlogs in courts and other issues in execution have warranted some amount of introspection into possible modifications to the process of insolvency resolution envisioned in the Code. Additionally, questions of whether adversarial mechanisms are truly necessary and best suited to resolving insolvency disputes have arisen, prompting a burgeoning interest in avenues such as Alternate Dispute Resolution (ADR) to be incorporated within the insolvency process.

Globally, the use of mediation in insolvency proceedings has begun to receive considerable attention and wider usage as a more efficient and well-suited mechanism to resolve a host of commercial disputes, including insolvency.[4] While mediation itself is in no way a new process, its usage in the field of insolvency and bankruptcy has warranted a re-examination, especially in light of the COVID-19 pandemic, into how dispute resolution and the interests of stakeholders may be best met outside the confines of the Courtroom.

In an Indian context, there exists conspicuously little scholarship or deliberation upon whether mediation can be inserted into the Indian insolvency framework. However, it is clear that with the onset of the pandemic and the international influence of mediation, especially in terms of its role in resolving several high-level and influential insolvency disputes, the Indian insolvency resolution mechanism would certainly benefit from considering such alternatives, especially in light of certain issues with its execution. This interest can be seen, though sparsely, in some of the works of contemporary legal scholars and practitioners.

Despite very little Indian introspection into the linking of the CIRP with mediation, this small yet gradually growing interest has allowed for a necessary re-examination of the objectives of the IBC, its resolution mechanisms, and the effectiveness of the traditional court system in meeting these objectives and resolving these niche disputes.

The following paper critically analyses the possibility of situating mediation within the Indian insolvency framework. It does this by borrowing from varied international perspectives in which mediation serves as an integral part of the insolvency process and attempts to reflect on possible learnings for the Indian jurisdiction, performing a cost benefit analysis about the suitability of mediation as a dispute resolution mechanism as compared to the traditional adjudication process. It further identifies key impediments within the existing Indian insolvency process and why these roadblocks may make introducing mediation a cumbersome process – however, devises potential ways forward through drawing from mechanisms that have made mediation a success in other jurisdictions.

MEDIATION IN THE INDIAN INSOLVENCY FRAMEWORK: A COST-BENEFIT ANALYSIS

Mediation as a form of dispute resolution has proven itself on a global scale, inching its way to becoming one of the preferred avenues for commercial dispute resolution in the modern day.[5] While arbitration's popularity is also on the rise to resolve commercially sensitive matters and niche disputes, its procedural nature makes it extremely similar in several ways to the courtroom process, as a largely adversarial system of justice.

Though such mechanisms each come with their positives and drawbacks, mediation's inclusion to the forefront of preferred dispute resolution methods is a welcome change in the global approach towards the resolution of commercially sensitive matters. It further displays awareness on the part of companies and stakeholders of the value of more cooperative, creative, and less aggressive mechanisms to reach the conclusion of a dispute. While the adversarial system has, over centuries, enabled and ensured a system of justice that punishes wrongdoers in the eyes of law, while safeguarding legal and social rights and standards, the extrapolation of this school of thought to the realm of business disputes may not always be ideal or productive.[6] This idea will be largely examined throughout this paper, engaged with by assessing the contours of mediation as a process as well as how it might be a superior forum to settle insolvency matters.

Mediation is broadly understood to be a facilitated negotiation, wherein two parties negotiate the terms of a settlement, under the guidance and facilitation of a neutral third party.[7] It roughly consists of four focal tenets: Firstly, mediation is an entirely confidential process. Unlike a Court-driven system, the parties as well as the mediator are bound by confidentiality throughout the pendency of the settlement and negotiation process. Secondly, it is a voluntary form of ADR. Being a party driven process, mediation may be ceased at any point at the behest of parties if it is unproductive or a conducive settlement is not reached. If parties have the legal authority to settle the dispute, a binding settlement may be arrived at. Thirdly, the mediator, or appointed third-party facilitator of the dispute, must be a wholly neutral and impartial party. The mediator may not entertain conflicts of interest or any bias towards any party or any aspect of the subject matter of the dispute. Finally, mediation is a process of self-determination. The parties have full autonomy over the process and may choose to not adhere to any suggestions by the mediator, who is barred from giving any order to be complied with. Any settlement arrived at by the parties is purely of their own volition and may not be influenced directly by the mediator in any way or form. Parties may only, if they choose, take on certain constructive suggestions by the mediator. Moreover, they may be guided towards a more productive discussion through the nudging of the mediator towards a settlement.[8]

The role and legal recognition of mediation is prevalent in both Indian, as well as international statutes. Under Article 4 of the Hague Convention for the Peaceful Settlement of Disputes, 1899[9], the principles above are enshrined within law, stating the purpose of the mediator as being the facilitator of disputes, bringing parties with opposing points of view to a mutually agreed settlement. Mediators are meant to, through their presence and guidance, diminish hostilities between the negotiating parties and attempt to ensure that the negotiation is productive, ideally reaching a conclusion of some form. Article 4 further touches of the role of the mediator and the value of mediation being a process of self-determination.[10]

The process in itself is one that is not formal in nature, unlike proceedings in courtrooms or Arbitral Tribunals. Mediation essentially limits the need for any formal rules of procedure, preferring instead to appear almost like an informal, confidential discussion between two parties.[11] The informal nature of mediation proceedings leads into one of its most focal positives – the ability to arrive at creative, mutually beneficial solutions that are devised by the parties and are formulated not through legal reasoning or technicality but by examining the most logical and beneficial solution at hand.[12]

This allows parties to be free and creative with their thinking. While a Court's perspective and interpretation relies on the legal standpoint of an issue and an application of law to a set of facts, mediation presents a less clinical alternative that keeps the interest and wellbeing of both parties firmly in mind. The leads to a second large positive in favour of the use of mediation – unlike an adversarial system, there exist no 'winners' and 'losers' in a mediation process. A successful mediation, alternatively, is characterised by the ability of both parties to stand to gain through the process. As elucidated in *Swiss Ribbons v. Union of India*[13], the IBC's strength is that it intends to maximise the benefit and gain of all stakeholders in the process, which lends it the status of being a landmark legislation. This makes mediation, the primary purpose of which is to ensure the benefit of all stakeholders, structurally most suited to carry out insolvency processes, which are stakeholder-driven and entirely based on mutual benefit of all parties.[14]

On the other hand, a Court proceeding, or Arbitral Tribunal will without fail be dependent on one party's loss and another's gain. Though this stems from a firm sense of justice and the implementation of a system premised on enforcing equality, a business dispute is often one that revolves around the balancing of all stakeholders' obligations and assets in a fair and equitable manner beneficial to all. Unfortunately, as such disputes have traditionally been decided within an adversarial system, this is often not the case in practice.

In the case of matters under the purview of the IBC, the National Company Law Tribunal (NCLT) is the appropriate forum for all matters pertaining to corporate insolvency. No other civil court or Tribunal may entertain such proceedings, as per the case of *Dhulabhai v. State of Madhya Pradesh,*[15] Justice Hidyatullah made explicit the concept of express and implied bars under the Civil Procedure Code, establishing that where an appropriate forum existed for the adjudication of a particular matter, the jurisdiction of civil courts or any other courts were thereby ousted. The NCLT, therefore, following the reasoning of the case, becomes the only forum with competent jurisdiction to hear matters pertaining to the IBC. This automatically greatly increases the burden on an already overburdened system to hear, decide, and dispose of matters within record time to hear each matter within a tight deadline. Given that it has been prescribed that insolvency matters ideally must be concluded within a timeframe of 270 days, the goal of a time-bound resolution process is entirely bypassed. Owing to backlogs, cases are not heard in time with urgency, and are processed at a snail's pace.[16] As time bound resolution is one of the cornerstones of the insolvency process, this is extremely troubling, especially as one of the primary reasons for the Code's inception was to fast-track an already extremely slow process. As insolvency is in itself a complex process, including with respect to the enforcement of resolution plans and liquidation, the NCLT finds itself sinking under the weight of an ever-increasing number of insolvency disputes. With a sharp increase in companies filing for insolvency following the advent of the COVID-19 pandemic, finding a tangible solution for this lacuna is becoming a more and more dire concern.

The decisions of courts and the impact of this burden can be seen through case law as well. Several research scholars and practitioners have cited time spent on litigating insolvency disputes as being one of the most significant time sinks in the insolvency process. As Indian courts became cognizant of the impracticality of completing the insolvency process within 270 days, the provisos to section 12(3) of the IBC were inserted via the Insolvency and Bankruptcy Code (Amendment) Act 2019, doing away with the 270-day limit and extending it to 330 days. Critics were soon to point out the lack of feasibility of a 330-day limit, as litigation severely increased the time limit for the adjudication of the disputes. These concerns were soon proven justifiable, through the Apex Court's judgement in the case of *Essar Steel v. S.K Gupta.*[17] Though the Court did not feel doing away with the limit entirely was wise, it ruled that proposing a mandatory ceiling limit would contravene fundamental rights, through Article 19(1)(g) of the Constitution. As per the Court, such a criterion would unjustly disallow the carrying out of business, as enshrined under Article 19. Hence, the Court decided to do away with the term 'mandatorily,' while keeping a tentative limit of 330 days for the conclusion of the CIRP and any litigation that arose.

Additionally, when discussing factors for extension of this time period, the Court noted that it would extend the limits wherein delays were caused owing to litigation, or due to lags in the NCLT or Appellate Court where the matter was being adjudicated. The Court held that it may also, if it felt that it was in the best interest of the stakeholders, choose to extend the time limit of 330 days.

The *Essar Steel* judgement is possibly one of the most significant IBC judgements in recent history, with the CIRP in the case lasting over 800 days. This was partially owing to the insertion of the provision of section 29A into the IBC, which served as a disqualifier with respect to the eligibility of a specified criteria of individuals from being Resolution Professionals (RPs). The validity of certain entities as RPs became a significant point of contention, and the resulting litigation was appealed from the NCLT, to the NCLAT, and finally the Supreme Court.

In addition to the insertion of section 29A into the IBC, litigation prolonged the process yet again when the plan submitted by the RP declared eligible, ArcelorMittal, was brought before both the NCLT and NCLAT under the allegation of unjustly creating a distinction between operational and financial creditors. Though the aforementioned plan was approved by 92.24% of the CoC, the NCLAT attempted to modify the plan to put operational and financial creditors on the same footing. However, the Supreme Court set aside the judgement of the NCLAT, opting to stand by the wisdom of the CoC.

These issues, the latter of which is especially common during insolvency processes, add significant amounts of time and wastage of resources to the insolvency process. Further precedent such as *Binani Industries v. Bank of Baroda*[18] have displayed issues where internal issues with stakeholders have vastly delayed the CIRP process, with several intermittent delays predominantly owing to litigation. While these issues certainly need to be acknowledged and resolved, the use of mediation allows such issues to be directly addressed and tackled in a creative, time-efficient manner, rather than causing severe delays.

Additionally, the expense involved in the enforcement of traditional insolvency proceedings often becomes extremely cumbersome for parties, both in terms of time as well as monetary cost. The IBC prescribes the appointment of an Insolvency Professional, who must be paid over the course of proceedings to essentially help engineer the trajectory of the process. This greatly exacerbates the cost factor, especially given that the purpose of the process is to help repay creditors and possibly revitalise companies unable to pay debts. As noted by several scholars, owing to mediation being a far less costly alternative, the impact on socio-economic factors and the broader insolvency ecosystem could make mediation a game changer in Indian insolvency.[19] As less funds would be spent on the process as a whole, monetary resources would instead be channelised on potentially keeping the company afloat, ensuring employment remains for employees, and more efficient allocation of resources. Additionally, possible relationships with vendors, buyers, and sellers, could be retained and possibly salvaged if the company was to be able to stay in business longer. More importantly, leftover funds could be used to help pay off creditors, thus being a far more efficient mechanism to ensure that stakeholders' interests are effectively met.

Furthermore, an insightful argument is brought to the fore by Dr. S. K. Gupta in his research paper calling for the inclusion of mediation within the insolvency process.[20] In the paper, he posits that mediation would help make resolving cross border insolvency disputes a far more seamless endeavour, by taking the example of Jet Airways' insolvency proceedings in 2019. While the State Bank of India (SBI)-led lenders' consortium had commenced insolvency proceedings in the NCLT, proceedings were parallelly undertaken in the Dutch Insolvency courts, for the sale of planes that had been taken over by the SBI. The NCLT, having been appraised of this parallel proceeding, was forced to commit to not liquidating the plane. Dr. Gupta therefore concludes that if the Jet Airways dispute had perhaps been committed to mediation, such a scenario would not have arisen. Such a conclusion is certainly made with strong basis – given the nature of mediation, the parties would have had the opportunity to control the proceedings and come up with a negotiated plan that served only the interests of the parties involved. No jurisdictional issues would have arisen, as mediation is not the correct forum to challenge the finer points of law, but simply to reach a solution that benefits both parties, irrespective of jurisdictional challenges and differences.

This point's significance is highlighted by the presence of a world following, or rather, living through, the COVID-19 pandemic. With a majority of businesses, as well as legal services being provided online, jurisdictional boundaries lie more blurred than ever. The introduction of Online Dispute Resolution, further bears testament to the importance of blurring boundaries and the fading importance of physical or geographic boundaries. This also means, however, that cross-border disputes are at a sharp rise, with no signs of stopping. Therefore, it is imperative that alternatives be examined, given the dire consequences that would otherwise befall insolvent companies if they were to proceed under the current insolvency regime, especially where it is difficult to determine matters of jurisdiction.

THE APPLICATION OF MEDIATION IN INSOLVENCY DISPUTES IN AN INTERNATIONAL CONTEXT

While mediation has not been enforced as a mechanism of resolution of insolvency disputes within the Indian jurisdiction, it has proven to be a resounding success in foreign jurisdictions. Nations such as the United States, Italy, France, Singapore, and many others have made it a matter of standard practice to refer insolvency disputes to the avenue of mediation. Studying these jurisdictions and their experience with incorporating mediation into their insolvency processes allows a glance into how doing the same in India may prove to be an extremely fruitful endeavour.

International efforts, especially in light of the COVID pandemic, have been greatly exacerbated on multiple fronts to offer a simplified insolvency process. Though efforts have also been inclusive of micro, small and medium-sized enterprises (MSMEs) and potential restructuring options that are more simplified for these smaller enterprises, an equal amount of deliberation has also been spent on mediation and insolvency.[21]

Several practitioners and scholars have noted the inclination towards simplification of the insolvency process as a by-product of the pandemic, by analysing differences in the manner by which restructuring matters have evolved after 2020 in MSMEs. The Singapore Convention Week of 2021 contained a panel discussion on *'Potential Uses of Mediation in Debt Restructuring and Insolvency,'*[22] organised in conjunction with the Singapore Ministry of Law and UNCITRAL, further highlighting the burgeoning and steadily increasing interest in the intersection of ADR and insolvency law.

As per research by law firms such as Norton Rose Fulbright, though the implications of applying mediation to insolvency proceedings has greatly increased following the advent of COVID-19, such interest is not a matter of recency. Several firms, businesses, and governments have been looking into the possibility of introducing mediation into restructuring processes far before COVID, owing to the flexibility and multiple benefits ADR mechanisms have to offer. Most significant of all ADR alternatives offered that have captured the interest of global insolvency regimes has been mediation.[23] As aforementioned, its unique and solution-oriented approach has made it an integral part of dispute resolution throughout multiple jurisdictions. Furthermore, it has become clear that companies subjected to mediation for restructuring proceedings often prove to have far better chances of a recovery.

In the case of MSMEs in particular, nations around the world have, post-COVID, made conscious efforts to simplify the process of insolvency and ensure a more streamlined, and less constrained process. This could possibly be extrapolated to a clear requirement for simpler, more efficient and party-driven solutions overall globally. Given that mediation serves as an important part of the insolvency process in several jurisdictions across the globe, ADR and less formalised processes are becoming a gradually more accepted mechanism to resolve insolvency disputes. It is interesting to note that, despite varying models of insolvency, from Singapore to Australia to the United Kingdom and United States, each nation has altered their frameworks regarding MSME insolvency to introduce a far more streamlined process.

While the United States has had a rich history of including mediation within its insolvency process, most jurisdictions had not necessarily contemplated such a step outside Europe and the United States. Recently, however, the World Bank and UNCITRAL have both made decisions to encourage the utilisation of mediation as part of their insolvency process. As of 2021, Recommendation B4 of the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes[24] have yielded considerable support to mediation as a potential solution for insolvency processes around the world. Furthermore, the UNCITRAL Legislative Recommendations on the Insolvency of Micro and Small Enterprises[25] have officially recognised mediation to ensure greater accessibility to insolvency mechanisms.

Additionally, the UNCITRAL Model Law on Cross-Border Insolvency[26] further provides robust support to the utilisation of mediation to settle insolvency disputes. As per Article 27 (a) of the statute, an individual or entity appointed by a Court may be appointed to resolve such disputes. Given the nod towards mediation by the Model Law, it is clear that mediation has been accepted on an international stage as being a fair, flexible, and new-age dispute resolution process.

More recently, the introduction of the United Nations Convention on International Settlement Agreements Resulting from Mediation, known as the Singapore Convention on Mediation, has laid the foundation for the enforcement of mediation settlements across borders. Though a relatively new legislation, introduced in the latter half of 2020, the introduction of a universally acceptable and multi-jurisdictional enforcement mechanism lends a backbone to furthering arguments for mediation as part of insolvency processes worldwide.[27] These significant steps show that across jurisdictions, and despite varying approaches to insolvency, mediation appears to be being adopted on a large scale.

For the reasons highlighted in earlier sections that represent the cons of the adversarial system in adjudicating insolvency disputes, it becomes clear that mediation stands out as a credible, well-rounded, and more importantly, internationally acceptable standard that can be imbibed within the Indian insolvency framework. To further this assertion, the use of mediation in insolvency can be assessed in other jurisdictions as case studies – most significantly, in the cases of regions such as the European Union and the United States, where mediation has thrived as being an integral part of insolvency mechanisms.

The European Union

The European Union has not adopted a formalised, or codified system of mediation within the insolvency process.[28] The region's tryst with mediation has been an extremely gradual one, adopting mediation organically through the jurisprudence of courts and case law. This is largely in contravention to mechanisms employed by nations such as the United Nations, where mediation is a codified and significant part of the insolvency process, both in theory as well as in practice.

The EU's primary objective in the introduction of mediation is the rescuing of the corporate debtor by means of ADR. An excellent example of the same is the German model of insolvency mediation, known as the *insolvenzplan*.[29] The process allows for the debtors and creditors to arrive at a settlement based upon facilitated negotiation between both parties. Furthermore, in the French jurisdiction, two special procedures allow for the use of mediation outside the scope of the Courtroom – the *ad hoc* mandate and conciliation.

However, none of the above processes compare as significantly as with the Italian model, which offers business owners and entrepreneurs a wide variety of methods at their disposal to undertake insolvency proceedings and debt restructuring. These can be done either entirely separate from or partially within the confines of a courtroom.

The Italian system is especially poignant for the analysis at hand, owing to its multifaceted and layered approach to insolvency.[30] Three instruments have been provided for the purpose of restructuring, which are applied depending upon certain factors, namely:

(a) The degree of intervention by the Court;

(b) The specific process; and

(c) The applicability of agreement contents to creditors who do not take part in the stipulated negotiations.[31]

Choosing between approaches largely comes down to the factors and circumstances in question. Hence, the type of company as well as the most efficient resolution geared towards keeping the company solvent determines how the matter is to be resolved.

The Recovery Plan, which is in essence a mediation, is known as the *piano di risanamento attesto.* This refers to informal proceeds that are commenced by the debtor when they are facing a temporary crisis. Through this method, the debtor will submit a plan that is certified by a qualified professional for debt recovery and rebalancing the financial situation.[32] However, discussions on this plan, and the agreement with respect to its terms is entirely private, between the parties involved. The assent of the creditors is sufficient, without any need to bring in courts in any form. It is binding only on the creditors in the negotiation.[33]

The Italian system also makes use of a hybrid model, or semi-formal proceeding, which takes the form of a Debt Restructuring Agreement or *accordo di ristrutturazionedeidebiti*. This is similar to the Recovery Plan, in that the dispute in itself is resolved through a negotiation. It largely conforms with the focal tenets of mediation, as outlined earlier, especially the mechanism of confidentiality. It is only binding upon creditors who have participated in the negotiation, with the court taking a purely supervisory role over the course of the proceedings, to ensure that they are legally sound.[34] No significant intervention, however, is made.

This particular form of Debt Restructuring Agreement is in conformity to the tenet of self-determination, as the creditors and debtors are able to come to an agreement of their own volition. Additionally, given the silent supervision of the court, such an agreement is made to the knowledge of the court while adequately monitored to ensure that the settlement is legal and does not contravene any provisions of law. The formalities provided, however, include a need for creditors representing at least 60% of debt exposure to sign the agreement, the introduction of a qualified professional to approve the scope and feasibility of the debt recovery plan, as well as the publication of the agreement in the Companies Register, along with relevant documentation. In addition to all such compliances, court approval is necessary.[35]

Lastly, a preventive arrangement with the creditors allows for an arrangement to be reached between the parties that is certified by a professional. The agreement will be provided and submitted to the creditors, and is a largely Court-monitored process, without the approval of which such a plan cannot be put into force. Following approval and the submission of the plan, a negotiation between debtors and creditors takes place, facilitated by a judge and Judicial Commissioner.[36]

The United States

The United States' method of Chapter 11 Insolvency is a debtor-in-possession model that greatly depends upon the process of mediation as a facilitative method to resolve insolvency disputes. Mediation was first suggested in America during the Pound Conference by Professor Frank Sander, who found that alternative dispute resolution mechanisms may prove to be even more efficient than the traditional court system.[37]

In 1986, the Bankruptcy Court for the Southern District of California established a mediation programme. Following the inclusion of mediation into legal practice, the United States has thoroughly utilised mediation in insolvency matters. In 2013, the case of *Thompson v. Greyhound Lines Inc.*[38] became one of the most significant court precedents in affirming the success of mediation mechanisms to resolve insolvency disputes. The case revolved around a pre-reorganisation mediation plan for thousands of claimants, who brought suits of personal injury and property damage claims against the company owing to traffic incidents resulting due to the company's vehicles. The company, however, filed for bankruptcy. Despite thousands of claimants, the debtor, or the company, was able to deal with each and every creditor and reach a satisfactorily mediated settlement, by entirely being dependent on mediation.

The mediation was broadly divided into three key phases. Firstly, the creditors completed claim forms to prove damages, such as medical bills and other documents that adequately supported their claims. Secondly, a negotiation stage took place, wherein damages claimed were negotiated. If the negotiation was unsuccessful, or if the creditors in question chose not to engage in negotiation, 60 days of mandatory mediation was undertaken. Lastly, in the event mediation was not successful either, the parties would seek recourse through arbitration.

Interestingly, most issues were resolved within the first stage itself. The case is an excellent example of the efficiency of negotiation and mediation as feasible insolvency mechanisms, both owing to the immense satisfaction provided to the parties through the settlements arrived at, but also the lack of adjudication or litigation costs incurred as a result. Furthermore, the case opened doors for the possibility of a win-win situation in an insolvency dispute, opening the floodgates to the far wider adoption of mediation in the American insolvency framework as a result. The sheer number of creditors, going into the thousands, bears testament to the edge that mediation has over adversarial processes in such a situation.

In the year 1993, the Southern District of New York's Bankruptcy Court brought into force mediation as a means for restructuring and insolvency proceedings.[39] One of its earliest and most notorious examples of restructuring disputes committed to mediation was the restructuring process of Macy & Co., one of the United States' most famous and successful department stores. High profile insolvency, since then, has not been an uncommon phenomenon. The US Bankruptcy courts in Delaware further referred a host of insolvency disputes to mediation, allowing for the normalisation of the process as being an integral part of American dispute resolution.[40]

Possibly the most famous example of the same, however, is the case of the Lehman Brothers insolvency proceedings, which were mediated, rather than overseen in court. The case study of the Lehman Brothers not only gives insight into the successes of mediation, but also provides the usefulness of the process as being a mechanism that is apt for cross-jurisdictional, complex commercial transactions, which appears to be the need of the hour given the current global commercial climate.

The case came into force with 75 legal disputes being commenced simultaneously, through 18 subsidiaries, spanning 40 jurisdictions. As a result, a tangled web of differing and inconsistent legal judgements followed, providing for an unsatisfactory conclusion to the fall of one of the world's most significant financial giants. Owing to lack of clarity on the front of the various legal proceedings, Lehman Brothers opted for a mediation process, reaching a settlement in 77 mediated settings. Not only was the process one that compensated the creditors of Lehman Brothers fairly and quickly, but the success rate of the mediation was incredibly high, with only four proceedings not leading to a fruitful conclusion. Both the cases of the Lehman Brothers as well as Greyhound Lines, display a clear ability of mediation to resolve, to the satisfaction of parties, some of the complex and legally ambiguous commercial disputes.[41] In a sense, the exploration of mediation in American insolvency displays that mediation shows an ability of ADR to reach a conclusion that would be unimaginable within a courtroom, at a speed with would be fractional when compared to that of a court.

The history of several high-profile disputes being resolved so efficiently has made the United States a nation that considers ADR an intrinsic part of resolving insolvency conflicts. In 1998, the United States entered into force the Alternate Dispute Resolution Act,[42] that specifically provided for the use of ADR in bankruptcy proceedings. It further recommended that every Federal District Court should authorise ADR, especially in matters pertaining to insolvency and bankruptcy. Furthermore, in 2004, the Bankruptcy Court for the District of Delaware established that before certain adversary proceedings, the parties must attempt to reach an agreement via mediation. Hence, ADR has been used in 60% of reorganisation cases in the United States between 2000-2011.[43]

The foreign application of mediation in insolvency matters appears to be on the rise. Though the United States and the EU have some of the most well-defined examples of the same, nations such as Singapore and the Netherlands also provide sufficient backing to the inculcation of mediation within insolvency proceedings. It is interesting to note that despite the relatively different forms of insolvency processes among these nations, mediation appears to have been a beneficial intervention irrespective of whether systems are debtor-in-possession or creditor controlled. While there are critics to this particular line of reasoning, this helps provide substance to the argument that utilising the examples of such cases provides a strong line of reasoning to prove that the Indian insolvency model would benefit considerably from mediation's application.

MEDIATION WITHIN THE INDIAN INSOLVENCY PROCESS: AN ANALYSIS

The above examples, though certainly illuminating, face several significant roadblocks in terms of being applied in the current Indian legal climate.

Moreover, despite the IBC's relatively short lifespan, it has proven to be immensely successful and a much-needed intervention within Indian bankruptcy law, offering a structured and balanced opportunity for creditors and debtors to resolve insolvency related disputes. Adding to this, in previous attempts made by parties to take their dispute to ADR, namely arbitration, courts have largely been reluctant to do so, as insolvency disputes tend to be *in rem*, and not *in personam*.

The Supreme Court in *Pioneer Infrastructure v. Union of India,*[44] held that proceedings within the purview of the IBC are proceedings *in rem*. Furthermore, as it is a settled point of law that *in rem* proceedings, being in the public interest, cannot be referred to arbitration under section 8 of the Arbitration Act, this may be easily extrapolated to mediation not being feasible either. This rule was first introduced by the landmark case of *Vidya Drolia and Ord. v. Durga Trading Company*[45], which dealt with the question of what is arbitrable and possible to be resolved through ADR. The concepts of *in rem and in personam* disputes were clearly elucidated, while insolvency disputes were named specifically as being in arbitrable in nature. A private, confidential settlement for matters that are *in rem* appear contradictory to the settled principles of law upheld by Indian courts. In a similar example, in the case of *Haryana Telecom v. Sterlite Industries*[46], section 8 applications were not allowed in oppression and mismanagement cases under the Companies Act, 2013, as it was held in the case that oppression and management cases were *in rem*.

The introduction of the Mediation Bill, 2021, further lends hope to a consolidated legislation on mediation within the Indian context. However, Schedule II places explicit bars on the feasibility of certain disputes being mediated. These can be extended to family and industrial disputes as well, making the legislation fairly restrictive in nature. Therefore, it remains to be seen how effective the Bill will be in actual practice and cannot be used as an accurate basis to determine whether it can help further the possibility of mediation within insolvency disputes.

The NCLAT has further taken a firm stance in this matter, that presents another significant challenge to the introduction of mediation for insolvency proceedings. In the case of *Jagmohan Bajaj v. Shivam Fragrances Private Limited*, it was held that the Code is rendered supreme in any cases pertaining to insolvency petitions. The NCLAT stated:[47] *'I&B Code is supreme so far as triggering of Insolvency Resolution Process is concerned and same cannot be eclipsed by taking resort to remedies available under ordinary law of the land.'*[48]

This clearly puts forth that any similar relief may not be granted outside the purview of the Code. The NCLT, or any adjudicating power, may not therefore refer parties to arbitration, mediation, or any other form of dispute resolution outside whatever is arrived at by the provisions of the IBC.

However, the previous legislations mentioned above certainly do make a strong case for a push towards mediation within the Indian context as well. With the previous Hon'ble Chief Justice of India, S. A. Bobde, making a strong case for mediation to be considered as binding at an international conference on 'Arbitration in the Era of Globalisation', there appears to be a newfound, and fairly recent surge towards the resolution of commercial disputes through mediation.[49]

This can be seen in terms of recent Indian legislation as well. The commercial courts, commercial division and commercial appellate division of high court (Amendment) Ordinance, 2018, saw the introduction of a new provision related to mediation, inserted through section 12A. As per the section, a suit relating to any commercial dispute cannot be filed under the Act, unless it relates to urgent interim relief, before first utilising pre-institution mediation, following procedure and manner as per rules prescribed by the Central Government.[50]

A recent amendment of the Consumer Protection Act, 1986, as late as 2019, provides for initial reference of disputes to be made to the consumer mediation cell for mediation. Under section 74 of the Act, the State Government is conferred authority to establish a consumer mediation cell for each district and state commission in the state. Under section 37 (2), if the parties agree to settle by mediation and give written approval, the District Commission will submit the issue of mediation within five days of obtaining consent.[51]

Most significant to the topic at hand, however, is the micro, small and medium enterprises (MSME) Development Act (2006). Section 18 of the Act references ADR as a resolution mechanism in such cases. Under section 18(1) of the MSMED Act, in the event of payment default, any party may submit the matter to the Micro and Small Enterprise Facilitation Council. Section 18 (2) puts into force a conciliation process which the Council may independently look into or refer to any ADR cell of its choice. The Act does not prescribe a fixed standard for this conciliation process. Under section 18(3), if a resolution is not arrived at by the conciliation process, the matter will be referred to arbitration.[52]

Furthermore, India is a signatory to the Singapore Convention (United Nations Convention on Mediation), with respect to international conflicts. This Convention, however, firmly encourages the settlement of disputes through mediation under various Indian laws and legislation.[53] It is pertinent to note here that the Singaporean government in 2017 proposed mediation, making a clear reference to the efficiency of the same in insolvency-related disputes. The Committee made a firm recommendation with respect to the use of mediation centres, with the use of mediators with experience in cross-border insolvency and restructuring.

The Singapore International Mediation Centre further brought about the SIMC COVID-19 Protocol, which offers companies the opportunity to opt for accelerated mediation, taking note of the possible impact of mediation in commercial disputes in coming times. [54]

Global trends, as well as Indian legislation and its clear acceptance and dependence on mediation appear to present mediation as a viable alternative certainly up for discussion in terms of insolvency proceedings. Moreover, the IBC in itself is subject to several issues that open discussion channels with respect to introducing mediation.

There appears to be, therefore, a definite need and gap to fill which can be adequately and efficiently filled by mediation – however, the inherent roadblocks within the Indian system make this a very difficult path to consider. That being said, as evidenced through this paper, the pressing need for the same cannot be denied. The dependence on interviews as forming a basis for research in this paper further displayed a certain desire and need for mediation's inclusion and belief in its success within Indian insolvency. Therefore, courts may be forced to reconsider the rigid stance taken with respect to the arbitrability (and subsequently ability to mediate) of insolvency disputes.

Given the time delays in resolving insolvency matters, an overburdened judiciary, and a 'win-lose' approach to the process, it certainly is valid to question whether alternative models, or perhaps, even more hybridised models may work better in the Indian context. This may further be observed specifically in the context of section 12A of the IBC, pertaining to one-time settlement offers.

INCLUSION OF MEDIATION IN INDIA'S INSOLVENCY PROCESS

While much of the existing sporadic contemporary legal scholarship on this subject draws on foreign perspectives to argue the pressing need for mediation within India's insolvency process, the last argument made by this paper will endeavour to present a counterargument to the same. Further, it will attempt to bypass this counterargument by situating mediation within the CIRP. Though this paper does not firmly only endorse the inclusion of mediation within a particular rule or provision of the Code, it believes doing so would be an excellent starting point in situating mediation within Indian insolvency, and allowing for further, greater strides forward in future.

Though the use of mediation in multiple jurisdictions supplies excellent points of analysis to strengthen arguments for the inclusion of mediation in Indian insolvency, they often fail to consider the fact that foreign insolvency systems often function incredibly differently to the Indian system, which is creditor-driven, following the enactment of the IBC. On the other hand, examples such as Italy, and the United States are heavily influenced by debtor-in-possession models, lending unique and difference balances of power between stakeholders.

In the Indian context, control of the insolvency process is disproportionately in the hands of the CoC. The entire aspect of voting on resolution plans, and driving these processes are largely enforced by the approval of the CoC, while debtors merely are part of the process. The commercial wisdom of the CoC, in several cases, including that of *Essar Steel,* has been treated as sacrosanct. Moreover, with the Indian business climate being largely made up of family-owned businesses, the balance of power between promoters, family owners, and creditors is particularly delicate and unique to the region. Therefore, Italy's clearly debtor-driven mechanisms, and the United States' debtor-driven Chapter 11 insolvency process, though excellent guiding milestones, may not at all be comparable to the delicate power imbalance between creditors and debtors in an Indian context. This is also due to priorities being extremely different – while the priority in Western nations in debtor-in-possession models is to continue the business as a going concern, the Indian model prefers to concern itself largely with the repayment of creditors and liquidation of the company.

Therefore, to begin with, this paper proposes the inclusion of multiparty mediation within section 12A of the IBC,[55] and regulation 30A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), which deal with the withdrawal of application process. This is owing to a few focal reasons. Firstly, the withdrawal of application process is an ideal procedural time to mandate mediation or negotiation – as the parties must reach a settlement to withdraw the application and endeavour to employ more creative forms of resolving and withdrawing the insolvency dispute. Furthermore, precedent such as the case of *Siva Industries* shows the willingness of courts to overrule the wisdom of the CoC in certain cases where they are unsatisfied with the method by which a negotiated settlement is arrived at. Finally, the particular balance of power between the CoC and the promoters and directors of a company, at this stage, would make it the ideal time to enter into mediation, as both parties see their interests largely aligned. Though both parties are unwilling to carry on with an insolvency process, they would be most receptive to a mediated settlement, and it would be a more seamless process to incorporate owing to a common desire to not engage with the insolvency process at large.

Another significant matter for deliberation rests upon the ability of an application to be withdrawn both before and after the constitution of the CoC – therefore, there would be flexibility in bringing the parties to a mediated settlement, especially if the CoC has not been formed. In such a case, one could bypass the requirement of depending upon any majority vote or other difficult considerations that would be brought about by the formation of the CoC and enter into a more equitable state of mediation.

As there has begun to be a call for the IBC to break away from being largely creditor-driven by scholars and practitioners, the inclusion of mediation in the process of withdrawal would be a timely intervention in introducing the same and setting the initial steps to possibly move away from largely creditor-driven insolvency mechanisms. Therefore, the use of section 12A of the IBC and regulation 30A of the CIRP Regulations may be an excellent pathway through which effort could be sustained to include mediation within the insolvency process.

Additionally, while the substance of these recommendations relies on the insertion of mediation within the withdrawal process, it may be equally beneficial to include mediation preceding the submission of the application under section 7 of the IBC. This would also be an effective and efficient solution, as it ensures that parties mandatorily, owing to the several benefits of mediation, have the chance to settle the dispute even prior to the application being made.

Considering that the overburdening of courts is one of the predominant concerns in the enforcement of the Code, mandatory mediation prior to the submission of the section 7 application, that would mandate mediation between the parties, consisting of creditors and debtors, as well as Resolution Professionals, would be an extremely positive step. Therefore, the proposal outlined in this paper consists of introducing mediation at two levels in the insolvency process – once, before the filing of the application itself, to ensure that the parties have a fair chance of reaching a settlement prior to initiation of the CIRP, and secondly, during the withdrawal of application, when parties are primed towards reaching a settlement. This would also ensure that courts would only hear cases for which settlements are not arrived at, giving fair chances to parties to reach win-win solutions through mediation at two points in the process.

CONCLUSION

While this paper has touched upon the possible lack of comparison between international insolvency and Indian insolvency, it is worth observing that the blurring of borders by COVID-19 has not escaped the Indian subcontinent. Therefore, the inclusion of mediation, owing to its several positive aspects, is a worthwhile consideration that must be included within the framework of Indian insolvency. Though some roadblocks must be first addressed within the Indian system, the reception of India to mediation as a process has been warm, truly allowing for the process of mediation to display its usefulness, including over that of courtrooms for certain disputes.

While the counter argument presented appears to largely show very little similarity between Indian and Western insolvency, the mediation's efficiency in repaying back what is owed and ensuring the satisfaction of all stakeholders makes it a resolution mechanism that cannot be ignored, irrespective of where in the world it is undertaken. Its positives, therefore, spanning a great majority of this paper, clearly outweigh any negatives and provide adequate reason and ground for looking for ways to bypass any existing roadblocks.

Most interestingly, in analysing how to fit mediation within Indian insolvency, a certain number of possible reforms to the Code are revealed – therefore, in attempting to solve the issue of not having a time-bound, efficient resolution process for certain disputes, many of the IBC's shortcoming may be further analysed. While making further arguments about the creditor-driven aspect of the Code is beyond the scope of this paper, it does allow for considerable deliberation upon the design of the code, allowing a broader question to be asked of who the Code is intended for, and whose interests it serves. Given that one of its most significant purposes is the balancing of interests of stakeholders, a sufficient critique and conversation may be sparked owing to attempting to fit mediation within Indian insolvency and the differences between the IBC and, for example, Chapter 11 Insolvency in the United States.

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2

LAST MILE FUNDING:

A WAY FORWARD

— *Ajanta Gupta and Ritesh Kavdia*

Executive Summary

Availability of interim finance is considered as an important indicator for strengthening of insolvency markets. If firms are to be turned around, interim finance must be available at early stages to keep intact the value of the firms. However, once a company enters the rescue process, obtaining finance becomes extremely difficult, as few lenders are ready to lend to a distressed company. The Bankruptcy Law Reform Committee (BLRC) recommended that lenders must be incentivised to lend by measures such as giving such financing top priority, expanded governance rights, and safeguards to protect creditor interests, etc.

Presently reluctant attitude of the lenders, infusion of new money at exorbitant rate, uncertainties related to interest coverage during liquidation beyond one year, non-use of Insolvency and Bankruptcy Fund (IBF), etc. demand for a relook into the interim finance provisions. If interim finance is not arranged timely and adequately, it would sound a death-knell for life of such firms and loss in terms of entrepreneurship, employment, and gross domestic product (GDP). The present paper attempts to depict the trend of interim finance and review provisions provided under the Insolvency and Bankruptcy Code, 2016 (IBC / Code) and the Regulations made thereunder to provide a conducive environment for widening and deepening of interim finance market in India for distressed viable corporate debtors (CD) aiding in value maximisation and more prospects for revival.

Keywords: Interim Finance, Rescue Finance, Super Priority, Interest Coverage, High Interest Cost, Insolvency and Bankruptcy Fund.

INTRODUCTION

'Insolvency is about financial death and financial rebirth'

- Elizabeth Warren

The Code is a paradigm shift in the law. The Code envisages resolution of the CD as a going concern, as termination of the CD destroys organisational capital and leaves resources idle till reassignment to alternate uses and meager likelihood of resolution. It, therefore, facilitates continued operation of the CD as a going concern during corporate insolvency resolution process (CIRP). To keep the CD as a going concern, section 14(2) of the Code declares moratorium and prohibits suspension or termination of supply of critical and essential services to the CD and enables raising interim finances for continued supply of goods and services. It precludes any action to foreclose, reclaim, or enforce any security interest during CIRP, thus preventing a creditor's individual interest from being maximised. The primary focus of the Code is revival/resolution and continuation of a failing, but viable CD. The success of a resolution in an insolvency regime is dependent upon numerous factors, predominantly amongst them, the time taken to initiate resolution process *vis-a-vis* recognition of stress in the firm, provisioning of facilitative measures, and availability of white knights as resolution applicants. The BLRC, which conceptualised the Code postulated that '*rescue financing can be a very effective way of preserving going-concern value for viable companies under financial distress and the law should provide for enabling provisions for the company administrator and the creditors to provide for such financing as part of a scheme of revival*'[1].

Sanctioning Interim Finance under the Code

One of the most significant facilitative provisions engrafted in the Code pertains to empowering of Insolvency Professionals (IPs) to raise interim finance (also known as rescue finance, post-commencement finance, debtor-in-possession (DIP) finance, etc.) with the approval of committee of creditors (CoC) during CIRP. Original section 5(15) of the Code defines interim finance as *'...any financial debt raised by the resolution professional during the insolvency resolution process period'*. The interim resolution professional (IRP) is authorised to obtain interim finance under section 20(2)(c) with a caution that no security interest shall be created over any encumbered property of the CD without the prior permission of the creditor whose debt is secured over such encumbered property. However, in cases where the value of such encumbered asset is not less than the amount equivalent to twice the amount of the debt, mandate to seek prior consent from a creditor has been relaxed. Further, section 25(2)(c) of the Code, which deals with 'Duties of Resolution Professionals,' allows the Resolution Professional (RP) to raise interim finance subject to approval of the CoC u/s 28 with a vote of 66% of the voting shares. The amount of interim finance raised during resolution period and cost incurred for raising such finance thereof[2] are components of insolvency resolution process costs (IRPC) under the Code and if a resolution plan is approved such CIRP cost have been fully covered to be paid in priority.[3] Even if no resolution plan is authorised, and eventualities as described in section 33(1) emerge, and an order of liquidation is issued. The recovery of liquidation costs, as well as IRPC, has been given first priority under waterfall mechanism.[4]

Despite shielding the interim finance and interest of creditors with 360 angle thought process, certain omissions in extending new financing were unfolded. Such as, it was noticed that the IRPC ends with the CIRP and thereby, interest on interim finance stops on the failure of CIRP. Certain periodical payments specified in IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations) in the words '*In the case of rent, interest and such other payments of a periodical nature, a person may claim only for any amounts due and unpaid up to the liquidation commencement date*' gave the impression that interest on interim finance availed can only be claimed up to the liquidation commencement date. Since liquidation turned out to be a lengthy process, the lender will not get interim finance repayment for a long time and creating a room that interim finance may not earn any income during this time. In 2017, Mr. Ravi Chandra founder of Eight Capital LLC expressed that '*one also needs to understand that the coupon on our loans stop ticking the moment the company enters liquidation. So, we are essentially looking at earning interest for a few months, but in turn we can get stuck for years in case of liquidation*'.[5] This inability to earn interest as no interest was provisioned to be paid on interim finance if the firm goes into liquidation, creating strong disincentives for prospective lenders to participate in distressed funds market. Another hurdle faced by the lenders (primarily banks) in extending its hands for providing rescue funding was Reserve Bank of India's (RBI) stringent norms attached to the classification of account of CD. Further, need was also felt to enhance the scope of interim finance to respond the dynamics of the business environment.

Layers added to shield and expand interim finance

The Code is a unique legislation which is designed to resolve financial stress while safeguarding the interests of stakeholders. The RBI acknowledged the pressing need of interim finance facilitated under the Code, and via its Prudential Framework for Resolution of Stressed Assets in June 2019, provides for relaxation of provisioning norms for treatment of interim finance disseminated by banking institutions. Further, to address the ambiguity with regard to interest earned during the liquidation period for funding arrangement made during CIRP, a new sub-clause (vi) was added to regulation 2(1)(ea) Liquidation Regulations, which provides that '*interest on interim finance for a period of twelve months or for the period from the liquidation commencement date till repayment of interim finance, whichever is lower*' be considered as part of liquidation cost. Magnifying the scope of interim finance, following the IBC (Amendment) Ordinance, 2019[6], the definition of interim finance was amended by adding *'and such other debt as may be notified'*. In exercise of the said powers, the Central Government[7] notified the debt raised from the Special Window for Affordable and Middle-Income Housing Investment Fund I (SWAMIH), a fund sponsored by the Central Government for providing priority debt financing for stalled housing projects, as the interim finance. To establish a transparent and liquid market for stressed assets that allows stakeholders to realise the best value and viable businesses to be rescued, the Insolvency and Bankruptcy Board of India (IBBI) had set up online platforms for distressed assets, to facilitate gateway to markets, *inter alia*, for interim finance and resolution plans. Latest evolution under the Code is prepack, currently limited to micro, small and medium enterprise, has also come up similar provision for accommodating interim finance and its cost as it is under the CIRP. Needless to say, the Code is a living document and has been evolving with new frameworks and adaptions to provide a floor for every possible mechanism for revival.

PROBLEM STATEMENT

During Resolution

(a) Lenders' reluctance to extend interim finance – Evaluating the priority accorded

Section 5(13) of the Code considers any interim finance raised by the Insolvency Professional (IP) as part of IRPC, thereby, bestowing 'super-priority' status on such finances to be paid in priority to all other secured or unsecured claims during CIRP and liquidation process. Report by EY India on implementing the Code[8], highlighted that the existing lenders have been extremely reluctant in releasing interim finance in spite of the priority accorded to interim finance under the Code. IFC[9] talked about CoC's hesitance in providing interim finance to the CD because of risk-averse attitude toward lending, the availability of funding at a very high interest rate that would be unsuitable for the CD and may not be approved. Furthermore, if the new lenders demand security over the CD's assets, the CoC may not authorise. In an interview, Managing Director, State Bank of India[10] (in the background of onset of COVID-19 pandemic in 2020) had remarked that '*it is very difficult for any lender to disburse interim finance to the stressed firms which are undergoing insolvency resolution process since recovery will be a major concern … Even before the pandemic happened, interim finances were difficult. In this uncertain time, it will get more difficult*.'

It was indicated[11] that decision to raise interim capital, is rarely taken in the best interests of the CD, has been observed as one of omissions as a result of the CoC's lack of involvement in the process. It's most likely because creditors are wary of investing more money into a sinking ship. By exercising its ability to approve expenses, the CoC obstructs other critical operations such as running the CD as a going concern, determining avoidance transactions and marketing stressed assets in the market to maximise value. The CD and value maximisation suffer as a result of the CoC's failure to weigh such decisions in its favour.

Moreover, the restriction on interest cost on interim finance availed during CIRP for a maximum period of one year[12] from the liquidation commencement date creates deterrents for the lenders for participation considering the fact that 68%[13] of the ongoing liquidation processes are continuing for more than one year. Nevertheless, few lenders extended their arms to infuse new money and claimed interim finance as safe investment zone. However, it is gathered that rate of interest has been kept in 15-20%[14] and even 18-25% (legal pay)[15] by new lenders and remarked as grave dancers as to firefighters.

The uncertainties related to interest coverage during liquidation period beyond one year leading to reluctant attitude of the lenders and infusion of new money at exorbitant rate obstructing CoC's approval for interim finance demand for a relook into the priority provision to interim finance under the Code to strengthen the availability of finance timely with less burden of cost. During the CIRP, the IRP/RP must continue to operate the CD. Interim finance is frequently required to run it. However, if the CD is not in in pink of its health or does not have sufficient liquid assets to continue operations, it may be difficult for him at least at the same capacity and efficiency as before the CIRP. Failure to run it as a going concern could lower the CD's enterprise value and prevent it from attracting a good valuation or successful resolution plan. This may eventually push the CD in some cases towards liquidation, which may not be consistent with the objective of the Code.

(b) Pre-insolvency financing under interim finance

From foregoing as Central Government had notified a debt raised from SWAMIH as interim finance but the same has been left to the jurisdiction and intervention of the government. Prior to initiation of insolvency process under the Code particularly in force majeure circumstances or change of business equations, the company may require access to the liquidity. The Code has not catered to facilitate such pre-commencement of insolvency funding except through the definition of 'interim finance' which include, '*such other debt as may be notified*'. Having such mechanism by notification leads to long drawn process serving the CD in general not on a case-to-case basis. The creditors whose commercial wisdom have been regarded as supreme under the Code, have not been empowered to decide on pre-commencement of insolvency finance which otherwise would have great potential to rescue the company before dragging it in the operation theatre under the Code.

During Liquidation

(c) Elusive position of interest during liquidation period – insecurities to new lenders

Section 5(13) of the Code the term 'IRPC' also includes the amount of interim finance and the costs incurred in raising such finance. However, as per regulation 2(ea)(vi) of Liquidation Regulations, the 'liquidation cost' also means and includes the *'interest on interim finance for twelve months or the period from the liquidation commencement date till the repayment of interim finance, whichever is lower'.* The possibility that CD may undergo into liquidation and lender will face with huge losses on interest element, considered a biggest demotivator to provide interim finance.[16]

Pertinent to note that the intention under the Code appears to provide full priority to the interest cost for finance raised during the resolution period. However, Liquidation Regulations has limited its period by one year maximum. Doesn't such a provision in the Liquidation Regulations creates a void in the interim finance provisions stated under the Code? Such ambiguity needs harmonisation of provisions of interim finance under the Code and the regulations made thereunder.

(d) Constrained funding during liquidation — resisting short-term funds for going concern?

There is no explicit provision for raising interim finance during the liquidation period.[17]Despite rescuing the CD under the scheme of compromise and arrangement under section 230 of the Companies Act, 2013 and facilitating the CD to sell as a going concern during the liquidation period, the Code is silent on raising an interim finance during the liquidation process which is curtailing the liquidator's ability to fund the operation of the viable CD for shorter term requirements.

Insolvency and Bankruptcy Fund

(e) Unrecognised IBF — widening its usage

Section 224 of the Code talks about formation of IBF for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code. Though IBF has not yet been operationalised, however, the two sub-provisions of the Code i.e., section224(2)(d) and section 224(3) can be broadened to facilitate interim finance to viable and distress CDs aligning with the objectives enshrined while creating such fund under the Code.

Conventional Funding style

(f) Sources of finance – exploring innovative forms

Finding and raising interim funding is significant task assigned to RP during the CIRP. The RP's goal is to persuade all potential lenders since the CD is still a viable business. Banks, creditors, and shareholders are common financiers. Lenders will consider lending, if they believe the CD is viable and has a good probability of survival. For lenders, the sort of business and its current financial state, as well as the lender's risk appetite, determine the nature and scope of interim financing. The technological revolution in the financing sector has provided alternative forms of raising finance, such as crowdfunding, venture capitalists, private equity, peer-to-peer lending, Foreign Direct Investment (FDI) etc. which can be explored to identify innovative modes of last mile funding.

RESEARCH OBJECTIVES

To address the foregoing issues, the present paper has been designed to:

Depict the trend in interim finance availed by the CD's yielding resolution plans for its revival during CIRP and ordered for liquidation under the Code

Review provisions of interim finance provided under the Code and the regulations made thereunder in the light of practices across various jurisdictions to provide a conducive environment for widening and deepening of interim finance market in India.

DESIGN OF THE STUDY

Depicting trend of interim finance raised during resolution process for the CDs which have been successfully resolved during CIRP or ordered for liquidation.

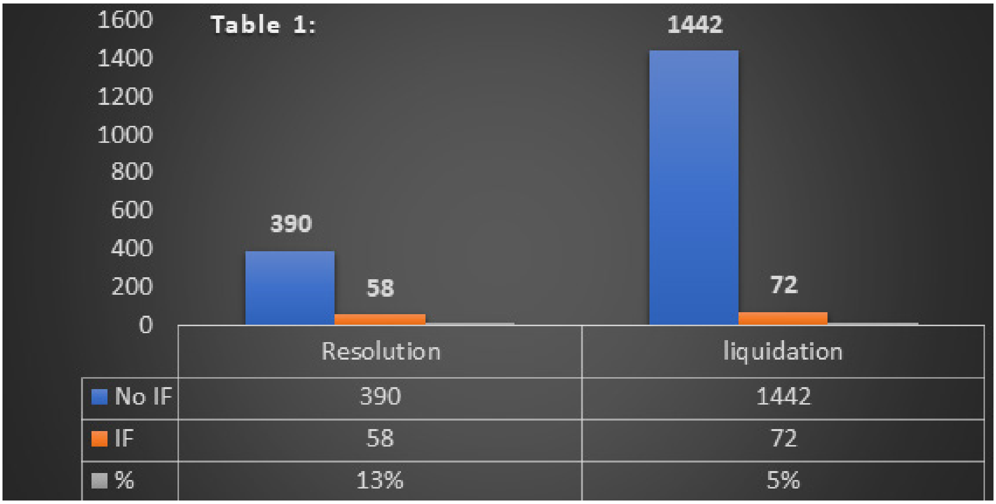
Objective: To present the broad view of interim finance availed during the resolution process, particularly for the cases wherein resolution plans have been received and for non-defunct companies who has potential to revive as to evaluate percentage of interim finance availed cases.

Sample size: As per IBBI Quarterly Newsletter, September-December 2021, the total number of companies resolved are 448 companies and ordered for liquidation are 1514 cases. As per IBBI data published on its portal enumerating the CDs yielding resolution and liquidation as on December 31, 2021 have been taken as base for analysis.

Methodology and Limitation: The information has been captured from the filing of cost disclosures made by the IPs on their respective Insolvency Professional Agency's (IPA) portal and are accessible to public, subject to availability of data.

The trends have been summarised in Table 1:

Table 1: Interim finance availed cases



Data Source: IBBI Quarterly Newsletter, September – December 2021
and IP cost disclosure at IPA website

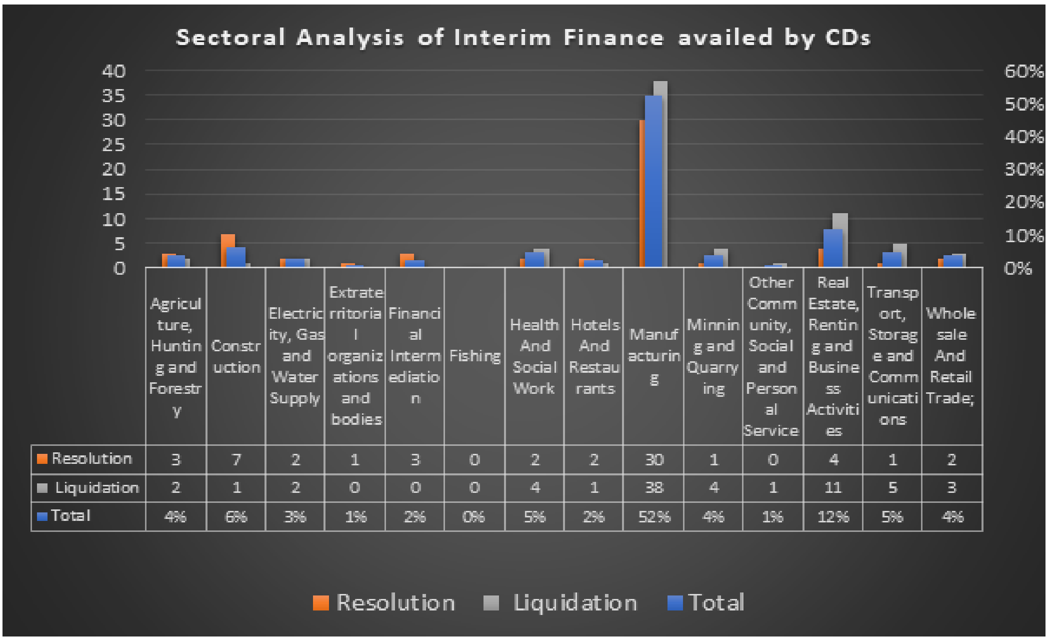
Observation: From table 1, it can be noted that a mere 13% (58/448) of CD's yielding resolution and only 5% (72/1514) of CDs ordered for liquidation have received interim finance. In totality, the interim finance percentage tends to be 7% for all the CDs whether successfully resolved during CIRP or ordered for liquidation.

Table 2: Interim finance availed by non-defunct CDs

	Non-defunct CDs	IF availed	Percentage
Resolution	299	40	13%
Ordered for Liquidation (Received Resolution Plan)	171	19	11%
Ordered for liquidation (no resolution plan received)	197	8	4%
Total	667	67	10%

Observations: The table 2 focuses on those CDs which are non-defunct and have potential revive at the earliest. It is observed that only 13% (40/299) of the non-defunct CDs which are resolved, received interim finance. It may be noted that this percentage further signifies the low market for the interim finance as though these CDs have been resolved but interim finance availability, if required, can help in enhancing the value, more prospective resolution applicants, timely resolution etc. Furthermore, the above table also showcase the CDs which are non-defunct and ordered for liquidation. This has been further bifurcated on the basis of resolution plan received. Shockingly, it is observed that only 4% of the CDs which are non-defunct, but no resolution plan received, availed interim finance and 10% in totality.

Table 3: Sectoral Analysis



Data Source: IBBI Quarterly Newsletter, September-December, 2021

Reviewing priority accorded to interim finance raised during resolution process:

'When restraint and courtesy are added to strength, the latter becomes irresistible'

- By Mahatma Gandhi

One of the biggest challenges before the RP in the restructuring of the CD under distressed is to protect and maintain the viability of the business of the CD. During the CIRP of going concern CD, the operations of the CD must be continued, and the CD must be able to pay its debts as they become due in the ordinary course of its continued trade. The expenses are incurred for operative and administrative purposes during the CIRP call for pressing requirement of funds to run the CD as a going concern and restructuring process of the CD. Interim finance work as an oxygen in the restructuring process, if not arranged, the CIRP may be terminated and place the CD into liquidation. Hence, it is very essential to persuade the interim financers. The BLRC which conceptualised the Code had acknowledged such challenges and observed that once a company enters the rescue process, obtaining finance becomes extremely difficult, as few lenders are ready to lend to a distressed company. It recommended that lenders must be incentivised to lend by measures such as giving such financing super-priority, expanded governance rights, and safeguards to protect creditor interests. BLRC while recommending such super-priority status, was concern with the issue whether such financier can get priority over existing secured creditors, given that the company may have no unencumbered assets. This position had already been clarified under the Code by placing interim finance and its cost under CIRP expenses ahead of all old debts. Despite prioritising the interim financing ahead of pre-insolvency debts, existing financial institutions have been hesitant to provide interim financing. Even if an external lender is willing to offer interim funding, the high interest cost element is pushing back the existing lenders to take decision on infusion of new funds to distressed CDs.

Mr. Uday Kotak[18] observed that, there appears to be some reluctance among CoC members to provide such critical interim funding, owing to a lack of clarity on granting priority charge to any possible temporary finance provider. Due to lack of options, RP's have turned to the tribunals for help, requesting that CoC members give or enable interim financing. In *Sai Regency* matter, the Adjudicating Authority[19] (AA) acknowledged the importance of interim finance and observed that, CD is a going concern running with 100 employees, in case the interim finance is not released, the CD will come to a grinding halt. On appeal, the National Company Law Appellate Tribunal (NCLAT)[20] declined to interfere in the collective decision of COC and observed that '*The dissenting Financial Creditor in COC cannot be allowed to scuttle CIRP process otherwise the provision permitting COC to take decisions with regard to subjects stated in Section 28(1) by given majority of 66% under Section 28(3) would be rendered nugatory*.' NCLAT relied upon the Hon'ble Supreme Court judgement[21] which upheld that the commercial wisdom of the individual financial creditor is non-justiciable. It is the duty of the RP to raise interim finance under section 25 of the Code and he is empowered to raise interim finance if it has been approved by the CoC with at least 66% majority, and the collective decision of the CoC is only enforceable.

Jurisprudence for interim finance is not yet matured since culture of interim finance to distressed CDs is under the developing stage in India. Private players have been seen as participants offering high interest rates considering ill-health of the CD. The provisions of interim finance are not being carried out as envisioned due to presence of gap lying in risk-averse attitude. New money is crucial at early stages to provide liquidity in the hands of IRP/RP to perform its functions, maintain going concern status of the CD, save employment and value maximisation. To address this gap, the need to accord new priority to interim finance under the Code have been expressed to create robust distress financing mechanism.[22] BLRC indicated that '*internationally, there is recognition that provision of super-priority for rescue finance is crucial for a successful rescue*.' United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law recommends that the insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative, with the provision of priority or security for repayment to the lender. The European Bank for Reconstruction and Development's, 10 Core Principles for an Insolvency Law Regime states that super-priority new financing should be permitted in cases of corporate restructuring (Core Principle 8).

In UK, under the Insolvency Act, 1986 (IA 1986) administrator is empowered to borrow funds on security of assets of the company.[23] Insolvency Rule 3.50[24] specifies which expenditures, charges, and expenses incurred during the administration can be classified as administration expenses. Insolvency Rule 3.51 deals with the priority of expenses (i.e., the order in which different categories of expenses are paid). Para 99 of Schedule B1[25] under IA 1986 provides new debts (incurred under contracts entered into by the administrator in the carrying out of his functions) are paid before other expenses (including the administrator's own remuneration) and floating charge claims in the administration. In complex financing situations, one seeks court approval for the financing arrangements, including any security or priority features. Thus, the post-commencement financing enjoys priority in payment to administrator's remuneration and expenses, floating charge debt and preferential debt (i.e., employee's claim) except the fixed charge debt. In Singapore under judicial management (i.e., reorganisation) of the company[26], the Court may, on an application by the judicial manager (i.e., administrator), determine the priority of the rescue finance, even higher than that of existing security interest, under the Insolvency, Restructuring and Dissolution Act, 2018. In South Africa, Companies Act, 2008[27] allows the business rescue practitioner to raise post commencement finance. Such finance will have preference over unsecured claims but paid after the remuneration and expenses of the business rescue practitioner, employee claims and claims of secured creditors.[28]

Rescuing companies which are DIP regime, US has established four DIP financing methods under section 364 of the US Bankruptcy Code. The first mechanism does not require court approval and permits the debtor to get unsecured credit in the ordinary course of business; nonetheless, the credit must qualify for administrative expense treatment. The second method allows for funding for non-routine business activities, but it must be allowed by the bankruptcy court after sufficient notice and hearing, and it is also unsecured. The third mechanism allows the court to provide DIP credit with super-priority status, meaning that DIP loans take precedence over administrative costs and a lien on unencumbered assets, a junior lien on encumbered assets, or both. The fourth mechanism provides the highest level of security for DIP financing by securing it with a senior or equal lien on assets that are already encumbered by a lien.[29] It may be noted that Singapore, in order to establish its position as international restructuring hub, has taken extraordinary measures and provided super-priority to post commencement finance, largely inspired by the US Bankruptcy Code. In May 2017, Singapore amended its Companies Act and empowered courts to grant the super-priority status to post commencement finance.[30]

From forgoing discussion, it is observed that US and Singapore allow super-priority status subject to Court approval after due consideration of protection of interest of secured creditors and UK allows priority to interim finance among other administrative costs (i.e., setting hierarchy with the administrative expenses). Integrating practices of these jurisdictions, treatment of the interim finance cost (principal and interest thereon) under the Code as super- priority status (paid ahead of all other costs) within IRPC can be analysed in following three alternatives: Firstly, Court intervention for granting super-priority status. Under the scheme of the Code, role of the AA has not been envisaged for the approval of interim finance. The Court involvement w.r.t. to super-priority status to interim finance may not be appreciated since such decision falls under the commercial wisdom of the CoC and also, keeping in view pendency with the AA. However, role of the AA is of supervisor under the Code and adequate enabling provisions have been provided under the Code to approach the AA in case of any dispute or matters related to proceedings under the Code. The other mechanism can be providing a super-priority status to interim finance with the approval of the CoC. While deciding for infusion of interim finance, the CoC may also decide to provide preferential status to the payment of interim finance under IRPC. However, when creditors decide to approve interim finance for the CD undergoing CIRP, there is inbuilt intention to be paid back. Hence, providing an option to creditors to accord the treatment of interim finance may (a) prejudices creditor's conduct for timely serving of the debt and (b) negatively impact the behaviour of the lenders which is presently being faced despite having priority in payment before all debts.

Lastly, it can be through explicit provision to provide interim finance as super-priority in CIRP and liquidation cost, to be paid ahead of IRP/RP/Liquidator's remunerations and other insolvency and liquidation cost. In US and Singapore, court approve super-priority status after due consideration of protection of interest of creditors. It may be noted that the Code provides adequate safeguards to protect the interest of the creditors while permitting the interim finance funding under the processes of the Code. Sections 20(2)(c), 25(2)(c) read with section 28(1)(a) of the Code empowers the RP to raise interim finance with the approval of CoC and the same has been accorded priority over payment of all other debts of the CD by classifying it as one of the components of IRPC under section 5(13)(a) read with section 30(2)(a) of the Code. Further, no security interest shall be created over any encumbered property of the CD without the prior permission of the creditor.

Granting new super-priority to interim finance over all the costs incurred during the processes of the Code will empower the RP to have more negotiating powers in terms of quantum and interest cost along with other qualitative terms and conditions timely and effectively, which presently being exploited by the external lenders through exorbitant interest rates. A psychological reassurance to lenders by eliminating confusion will bring a behavioural change among them and will be one of the most prominent effects of this change in the distress lending market. Further, there can be instances where the RP finds that despite having valuable assets, cash crunch bottleneck is creating hurdle in rescuing the financially distress and viable firms. It is pertinent to mention that regulation 29 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulation, 2016, (CIRP Regulations) enables the RP to sell the unencumbered asset(s) of the CD, other than in the ordinary course of business, 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 subject to the approval of the CoC and with a mandate that the book value of all assets sold during CIRP period in aggregate shall not exceed ten percentage of the total claims admitted by the RP. The conditions envisaged in the foregoing regulation limits the borrowing in the hands of RP's. It cannot be denied that the distress CD may not left with unencumbered asset since the promoters must had availed all the opportunities to procure the funds on any leftover assets of the CD prior to CIRP. On the contrary, the CD may have unencumbered assets and selling such unencumbered assets at nascent stage may be not result in better realisation of that assets otherwise placed in the resolution plan/sold as a going concern. Thus, adopting super-priority to interim finance provision may help to resolve the initial stage financial issues faced by RP for running the process under the Code. Time is essence of the Code. Timely disposal of funds has the potential to revive the operations of the CD and maintain the status of a CD as a going concern.

Recognising the need for granting the super-priority status to the interim finance to all other costs, the Insolvency Law Committee (ILC) in its February 2020 Report deliberated on the issue but somehow denied its super-priority status on the premise that it would be unfair to put suppliers lower in hierarchy who are mandated to provide critical and essential goods and services. Section 20(2)(e) of the Code gives power to the IRP (subsequently RP) to take all actions as are necessary to keep the CD as a going concern and in such a process of managing the business operations of the CD. Procurement of interim finance during the resolution process under the Code is meant for meeting the operational expenses which *inter alia* covers the dues of critical and essential service providers. It is RP's responsibility and accountability to be vigilant in usage of the interim finance fund during the process bundled with CoC's supervision. Need to mention that due to lack of availability of interim finance, not commencing the business operations of the CD in garb of positioning of suppliers shall led to death of the CD which has its own severe repercussions like non consideration of employment opportunities, destructing the value of the CD, no bid for resolution plan etc. Looking at different view, providing interim finance to viable firms can help in maintaining a client customer relationship in view of exchange of goods and services and further increases turnover not only of the CD but also to the suppliers.

The company has been observed as a modern engine of growth which produces goods and services, generate income and employment, and contribute to GDP. It takes years to build a company and leaving such companies to death bed due to unavailability of finance could act as a barrier to achieve the objective of the Code. The more secure the new financier, the lesser the interest burden, the early the funds availability and higher the probability of resolution. Since adverse riskelement in new financing can be overcome by super-priority status to interim finance, lending at bank rate can be stipulated to support the CD in distress time. Regulation 2A of the Liquidation Regulations provides that the liquidator shall call upon the financial creditors (financial institutions) to contribute the excess of the liquidation costs over the liquid assets of the CD, as estimated by him, in proportion to the debts owed to them by the CD, which shall be repayable with interest at bank rate referred to in section 49 of the RBI Act, 1934 (2 of 1934) as part of liquidation cost. Accordingly, it is further pointed out that proposed super-priority status along with interest element at bank rate can effectively serve to achieve the objective of the Code.

Finance raised prior to initiation of insolvency process

'True prevention is not waiting for bad things to happen, it's preventing things from happening in the first place.'

- By Don McPherson

The practice of according to priority to repayment of finance raised prior to initiation of insolvency process during the process could be traced in UK. The Corporate Insolvency and Governance Act, 2020, UK has introduced a new standalone moratorium procedure for companies to deal with COVID-19 pandemic. If within 12 weeks of the end of moratorium, a company enters into administration or liquidation, unpaid moratorium debts and priority pre-moratorium debts are given priority ranking in the insolvency distribution waterfall. Such debts are to be paid out after fixed charges but ahead of insolvency practitioner expenses and remuneration, preferential creditors, the prescribed part and floating charge holders. In India, SWAMIH has been notified by the Central Government allowing pre-commencement finance shield under the provision of interim finance under the Code. Funding at early stage of detection where the revival possibilities are maximum, can stop the company to be dragged under IBC. Dr. M. S. Sahoo, Ex-Chairperson of IBBI said that '*The best use of IBC is not using it*'. Deliberations with Indian Bankers Association (IBA) and other stakeholders can envisage such financing under the Code, with safety measures like subject to the special resolution passed by the members of the company in addition with the approval of the three-fourth of creditors etc.

Reviewing interim finance provisions during liquidation:

Presently, for CD under liquidation process, the interest payable on interim finance raised during the CIRP gets priority in repayment for the maximum period of 12 months and the balance amount gets ranked for repayment almost at the bottom (above only the shareholders) of the waterfall mechanism defined under section 53 of the Code, which may act as a dampener to financial institutions willing to lend interim finance. In the absence of adequate protection, interim finance providers would be at a losing end, if full coverage of interest cost during liquidation are not prioritised. This can be further appreciated from the fact that more than 50% of the ongoing liquidation cases (893 in number) have already crossed the prescribed one-year time mark undergoing liquidation process, as on September, 2020 which call for emergent consideration for change in interim finance provisions under the Liquidation Regulations. UNCITRAL[31] also provides that once the reorganisation proceedings are converted to liquidation, the insolvency law should specify that any priority accorded to such finance in the reorganisation shall continue to be recognised in the liquidation. The unclear provision[32] of interim finance claims to be handled in liquidation has effectively restricted access to money during the resolution process and, on balance, constrains rescue process.

Further, another grey area observed as inability to raise interim finance during liquidation[33]. In UK[34], Singapore[35], Australia[36] and South Africa[37] where the creditor-in-control insolvency model prevails, liquidator have also been permitted to raise interim finance. However, under the Code, the interim finance can be raised only during the CIRP, with no provision for soliciting the same, especially from outside creditors, during liquidation process. The non-availability of interim finance may hamper the operations of CD, which would have an adverse impact on the prospect of sale as a going concern of the CD under liquidation. Thus, the option of raising interim finance by the Liquidator and according highest priority even to the interest payable on such finance beyond 12 months need to be provided under the Code. Such provision would incentivise the outside as well as existing creditors to provide much needed respite in terms of finances to the distressed CD.

Aligning IBF for disseminating interim finance for the processes under the Code.

What is Insolvency and Bankruptcy Fund and its present status?

Section 224 of the Code provides for the formation of the IBF '*for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code*'. Section 224(3) of the Code only allows those persons who have contributed to the IBF to withdraw from it to the extent of their contribution post approval of the AA for making payment to workmen, protecting the assets of such persons, meeting the incidental cost during the proceedings or such purposes as may be prescribed. The Code created an IBF, but it does not specify the manner in which the Fund will be used.[38] It is pertinent to mention that IBF has not been operationalised yet. Trapping the conceptualisation of IBF in the BLRC Report, it is observed that BLRC had not provided any guidance on the establishment of such Fund. However, Notes on clauses to section 224 of the IBC, 2015 Bill as introduced in Lok Sabha has merely provides that clause 224 of the Code seek to constitute IBF for the purposes of processes under the Code which shall be contributed by the Central Government in form of grants.

Unleashing the utilisation of IBF:

Ministry of Corporate Affairs in its Consultation paper[39] dated December 23, 2021 invited the comments from public on proposed changes to the Corporate Insolvency Resolution and Liquidation Framework under the Code *inter alia* includes the section 224 to allow the Central Government to prescribe a detailed framework for contribution to and utilisation of the IBF. It felt that the current design of the IBF does not incentivise contributions to it and provides very limited ways of utilising the amounts contributed. Thus, it sought suggestions for identification of specific and wider uses of the IBF, *inter alia* to support some expenses of resource-strapped insolvency proceedings, such as payment towards workmen's dues, or for carrying forward avoidance proceedings, etc.

It may be noted that section 224(2)(d) of the Code talks about the interest or other income received out of the investment made from the Fund which shall be credited to IBF. With regard to the usage of the IBF for providing resources to support insolvency proceedings under the Code, it is advocated that section 224 of the Code may be permitted/utilised to facilitate the interim finance to cash strapped insolvency proceedings. This suggestion can be viewed under the ambit of '*meeting the incidental cost during the proceedings or such purposes as may be prescribed*' stated in the utilisation of IBF under section 224 of the Code. Although it is important to ensure the availability of interim finance to viable distressed CD, simultaneously it is equally necessary to protect the investment of such IBF to ensure availability of such fund to other CD facing liquidity stress in future. The interim finance facilitated from IBF shall also be safeguarded under the proposed treatment of interim finance i.e. according super-priority status to all other IRPC in the present paper.

Identifying innovative models of interim finance

'A tiny spark ignites a flame, just as a helping hand can do the same'

- By Nonnie Jules

World Bank's publication on Principles for Effective Creditor Rights and Insolvency Systems[40], observed one of the principles for successful post-commencement financing is that the business should have access to commercially sound forms of financing to enable the debtor to meet its ongoing business needs, subject to appropriate safeguards. UNCITRAL Legislative guide on Insolvency Laws guides that, there are a variety of ways that may be used to secure post-commencement funding and ensure repayment. An insolvency representative or a DIP may treat trade credit or indebtedness incurred in the ordinary course of business as an administrative expense. When obtaining credit or incurring debt is necessary to maximise the value of assets and the credit or debt is not otherwise available as an administrative expense or is to be incurred outside the ordinary course of business, the court may allow the credit or debt to be incurred as an administrative expense, given super-priority over other administrative expenses, or supported by the provision of security on unencumbered or partially encumbered assets.

Sources and forms of funding: The following presents the various sources and forms of interim finance that can be raised during the CIRP/Liquidation process under the Code:

Existing lenders: Long term/ Short term Finance: Lenders having continued relationship with the CD may advance fresh money or offer new terms for trade credit in order to improve their chances of recovering their current claims by providing continued finance. In the case of post-commencement financing, additional security may or may not be provided to lenders. However, super-priority status to interim finance can help the lenders to provide finance without additional security.

New lenders: Long term/ Short term Finance: Third-party/new lenders who have no past relationship with the CD may be motivated by the chance of making a profit by financing to the troubled company at favourable interest rates or repayment conditions. New lenders may provide interim financing under a 'loan to own' approach with the goal of becoming the company's new owners.

Non- fund-based facilities: Enhanced limits of Bank Guarantees (BGs)/Letter of Credit (LCs): Non- fund-based facilities in form of extension of limits of BGs and LCs can provide working finance to the CD to carry its day-to-day operations smoothly.

Receivables factoring: Factoring is a receivables management and financing strategy that aims to boost cash flow and protect the seller's credit risk. Factors are financial companies that pay cash against a client's credit sales in exchange for the right to collect future payments on those invoices from the client's debtors. It can be a beneficial source of funding during the CIRP for receivables that existed prior to the CIRP as well as new receivables that arise during the CIRP.

Shareholders eligible under section 29A of the Code to submit the resolution plan: Woking Capital Finance/ Long term Loan: CD can get additional cash in the form of working capital or a long-term loan from their shareholders who are entitled to submit a resolution plan under section 29A of the Code and are interested in saving the company. Shareholders, especially those in management or directorship roles, can act as prospective financiers during the CIRP.

Non-Banking Financing Companies (NBFCs): Due to their major strategic objectives, NBFCs engage in the lending and advances industry, as well as the acquisition of shares, stock, bonds, hire-purchase insurance, and chit-fund business. NBFCs can help the CD by providing financing in the form of loans or advances to cover the CD's short-term needs for day-to-day operations.

Alternative Investment financiers: distressed lenders and private equity firms: Private equity (PE) firms, venture capital (VC) firms, and distressed lenders (DL) are part of a new group of financiers known as alternative investment financiers. These organisations have a higher risk tolerance. Typically, such firms would buy distressed debt and/or have PE/VC money available for this reason. The higher risk-return investment, buying debt or assets at bargain prices, higher payment priority in terms of interim finance rankings, and potential debt-to-equity swaps in cases where they have identified a viable business with long-term prospects are all potential incentives for them to enter this industry.

Debt Mutual Funds can make short term investment in CD securities keeping in view that the amount invested in CD have priority in payment under waterfall mechanism as per section 53 of the Code and returns are assured. Thus, it can be another form of interim finance which can be made available to the CD during the CIRP.

Acquisition Financers: While the acquisition transaction is being finalised, the possible buyers of the CD also ensure CD's continued administration, and overhead and operating costs are timely paid to continue its operations as going concern.

Regulation 29 of CIRP Regulation: The resolution professional may sell unencumbered asset(s) of the CD, other than in the ordinary course of business, 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. In the matter of *Jet airways*[41], the RP brought into the notice of the CoC that with regard to six aircrafts taken on finance lease a finance upto USD 25 million is required for settlement with the Financial Lessors, to gain title position of the assets in favour of company. The CoC resolved for raising additional interim finance for specific purpose and for having first charge on security over the aircrafts/ engines recovered in the process.

The market for interim finance in India is relatively undeveloped. The priority accorded to interim finance under the waterfall mechanism as per section 53 of the Code have potential to attract non-traditional players who specialise in distressed lending and special situations, existing lenders looking to defend their exposure and new lenders looking to implement loan-to-own strategies. Further, suppliers of goods and services on credit and customers who provide advances during the restructuring process where there are no available assets to be put up as security seen to be expenses incurred in the operation of the business and are typically entitled to be paid as administrative / going concern expenses. With regard to treatment of receipt of advance payments for supply of goods, NCLAT[42] has also clarified that advance payment for the supply of goods during the CIRP would have to be treated as IRPC, not an interim finance. Other options for encouraging interim finance can also be looked upon like removing restrictions on foreign capital, encouraging the participation of Alternative Investment Funds, and even tax incentives, which would allow the market to appropriately price the risks associated with interim financing.

CONCLUSION

'Interim finance is 'like oxygen' to ailing companies and is indispensable…
If the IBC has to succeed, then interim finance is a must.'[43]

The Working Group on Tracking Outcomes under Code[44] in its Report has identified the six layers of outcomes of an insolvency and bankruptcy regime *inter alia* the growth and efficiency of markets for interim finance. It suggested that availability of interim finance as one of the indicators for strengthening of insolvency markets with the objective to aid the insolvency processes to arrive at competitive market outcomes. UNCITRAL[45] guides that the purpose of provisions on interim finance in rescue legislation to facilitate finance to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate. If firms are to be turned around, interim finance must be available at early stages to keep intact the value of the firms. However, certain level of certainty is necessitated through special preferential treatment in the restructuring waterfall of payments of loan and credit facilities provided by such financers to get the nod on first instance. The manner in which these claims are ranked, and a priority provided over others, will be the driver of the source and availability of interim finance during the CIRP of the CD under distress. From foregoing discussion, various measures such as (a) new super-priority status to interim finance under the Code (b) new money facility during liquidation for availing short-term fund to run operations of the CD (c) covering full interest cost during the liquidation period for funds availed during CIRP (d) exploring new avenues of finance can be looked up to ease CoC in decision making for timely access to interim finance. If interim finance is not arranged timely and adequately, it would sound death-knell for life of such firms. In nutshell, the provisions of interim finance under the Code and regulations made thereunder need overhauling to provide a robust finance procurement system for distressed viable CDs aiding in value maximisation and more prospects for revival.

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3 Section 30(2)(a), IBC.
4 Section 5, IBC.
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20 *Edelweiss Asset Reconstruction Company Limited v. Sai Regency Power Corporation Pvt. Ltd. and Anr.,* 2019 NCLAT No. 887 of 2019.
21 *K. Sashidhar v. Indian Overseas Bank and Others,* 2019, SC, Civil Appeal no.10673 of 2018. (We need to mention here SCC citation)
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23 Schedule 1(3), Insolvency Act, 1986, the administrator or administrative receiver has the "*Power to raise or borrow money and grant security therefor over the property of the company*."
24 The Insolvency (England and Wales) Rules 2016 states "***Order of priority.****.3.51.—(1) Where there is a former administrator, the items in paragraph 99 of Schedule B1 are payable in priority to the expenses in this rule…expenses of the administration are payable in the following order of priority…"*
25 Para 99 of Schedule B1, Insolvency Act, 1986 states *"(4)A sum payable in respect of a debt or liability arising out of a contract entered into by the former administrator or a predecessor before cessation shall be—*
(a) charged on and payable out of property of which the former administrator had custody or control immediately before cessation, and (b)payable in priority to any charge arising under sub-paragraph (3)."
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37 Section 386(5), Companies Act, 1973, it empowers liquidator that: *'(5) In a winding-up by the Court, the Court may, if it deems fit, grant leave to a liquidator to raise money on the security of the assets …'*
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42 *Tuf Metallurgical Pvt. Ltd. v. Impex Metal & Ferro Alloys Ltd. & Ors.,* 2021, NCLAT No. 190 of 2020.
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3

THE CONUNDRUM OF 'CLAIMS' IN THE CORPORATE INSOLVENCY RESOLUTION PROCESSES

— Anshul Agrawal, Akash Chandra Jauhari, and Raghavi R.

Executive Summary

A robust process of submission and consideration of 'claims' is the epicentre of the corporate insolvency resolution process (CIRP). It helps determine the liabilities and value of a corporate debtor (CD), provides a participatory opportunity to the creditors, and avoids extinguishing claims without due consideration. In the present article, an attempt has been made to understand the different modalities of the concept of 'claim', emphasising that a divergent approach is required for their consideration. The Code incorporates a broad definition of 'claims', including determinable and indeterminable rights, which are not limited to mere monetary obligations of the CD. Therefore, the consideration of the claims should be commensurate with the comprehensiveness of the concept of 'claim' under the Code. We have also analysed the domestic and international legal systems to highlight the best practices for assessing 'claims' submitted during the CIRP.

Keywords: Claims, Debt, Default, Financial Debt, Operational Debt, Right to Payment, Estimation of Claims, Extinguishment of Claims, Resolution Plan.

INTRODUCTION

Before 2016, decades-old laws governed the corporate insolvency and individual bankruptcy regimes principled on the colonial-era legacy. In 2015, the Bankruptcy Law Reforms Committee (BLRC) re-conceptualised India's corporate insolvency and personal bankruptcy regimes to suit the prevailing market conditions. Accordingly, the Insolvency and Bankruptcy Code, 2016 (IBC / Code) was enacted. The Code consolidates and amends the laws relating to the reorganisation and insolvency of corporate persons, partnership firms and individuals. The primary aim of the Code is to provide for time-bound processes, to enable the maximisation of the value of assets of such persons, to promote entrepreneurship, to improve the availability of credit and balance the interests of all the stakeholders.

The Code provides a state-of-the-art legal framework for India's insolvency and bankruptcy law to fulfil these objectives. The legal framework under the Code stands on certain essential legal concepts, like the concept of 'claim', 'debt', including 'financial debt' and 'operational debt', and 'default' which are relevant for different stages of the CIRP and liquidation process. Broadly, these concepts can be a part of the obligations of the CD, or which flows the forming of obligations or the breach thereof, i.e., liability.[1]

Regarding a 'claim', the Code has adopted a broad definition that includes a right to payment and a right to remedy for breach of contract.[2] As discussed in detail below, the definition of 'claim' has two facets. First, the nature of the right or the obligation of the CD is not limited to the monetary liabilities. Second, the status and time of performance of the obligation. Further, 'debt' means a liability or obligation in respect of a claim which is due from any person and includes a 'financial debt' and 'operational debt'[3]. The phrase 'liability or obligation in respect of' is prefixed to 'claim', further broadening the understanding of claims. Lastly, default means non-payment of debt when the amount of debt has become due and payable, and the CD does not pay it. The phrases 'non-payment' and 'due and payable' postulate that - (i) the concept of 'default' is related to the monetary liabilities which are certain, and (ii) such monetary liabilities are required to be paid immediately.

These concepts are adopted under the Code based on the context in which they are used. While the concept of 'default' and 'debt', especially the 'financial debt' and the 'operational debt', is relevant for the commencement of the CIRP, the concept of 'claim' and 'debt' finds its relevance in the CIRP and liquidation process.

CONCEPT OF 'DEFAULT' *VIS-A-VIS* THE COMMENCEMENT OF CIRP

Generally, the insolvency laws of different jurisdictions use two types of tests (or a combination of these two tests) to determine the standards for commencement of insolvency procedures, i.e. liquidity, cash flow or general cessation of payments test and the balance-sheet test.[4] The cash flow test is based on the company's inability to pay its debt or non-service of existing obligations as they fall due in the ordinary course of business due to insufficient cash flow.[5] The concept of 'debts' is strictly construed in determining a company's ability to pay its debts as they fall due. However, the balance sheet test indicates financial distress based on excess liabilities over assets.[6] It requires assets to be measured not against debts but 'liabilities', a more comprehensive expression.[7]

While recommending a triggering point for initiation of insolvency procedures, BLRC agreed that the subjective determination for admission, like the balance sheet test, will not be effective and recommended an objective test, such as the default test.[8] Accordingly, the Code adopts a modified form of the cash-flow test, i.e. default by the CD, for determination of insolvency of the CD and commencement of the CIRP. Further, as per BLRC, the Code assumes that, where a CD is undergoing financial stress, the CD and its creditors have already negotiated to keep the entity as a going concern.[9] The insolvency procedures specified under the Code are the last course of effort to resolve conflicts in the negotiations. Thus, the commencement of the insolvency procedures is a considered step after appropriate deliberation and preparation.[10]

Therefore, the Code adopted an objective test for the commencement of the CIRP. In this background, the requirement of 'default' is introduced under sections 7, 9 and 10 of the Code, and a suitable definition of 'default' is included. Also, an adjudicatory process before the Adjudicating Authority (National Company Law Tribunal) (AA) is provided to determine default. Suppose a 'debt' is due and payable, and the CD has not paid the same. In that case, a financial or operational creditor or the CD itself can approach the AA for commencement of the CIRP, which then admits the CIRP against the CD on the satisfaction of default of the prescribed threshold, i.e. one crore rupees.[11] The focus is on the monetary liabilities of the CD that it is immediately required to be paid. An objective test avoids delay in consideration of an application for commencement of CIRP before the AA. It ensures an easy transition to insolvency procedure for the continuance of the negotiations between the creditors and the CD.

CONCEPT OF CLAIMS *VIS-A-VIS* PARTICIPATION IN THE CIRP AND LIQUIDATION PROCESS

Once an application for commencement of CIRP is admitted, a moratorium is declared, and a public announcement calling for submission of claims is made.[12] A collective insolvency procedure is designed to ensure that the CD is placed in the hands of an Insolvency Professional (IP). A moratorium is placed to protect the estate's value against individual actions and facilitate insolvency procedures in a fair, orderly manner. Parallelly, all creditors participate in consideration of the liabilities owed by the CD against them while resolving insolvency and for distribution of liquidation estate in case of liquidation (i.e., when the insolvency resolution fails).

The primary procedure for participation in the CIRP and the liquidation process is the submission of claims. A creditor wishing to be a part of the insolvency procedures of a CD is required to formally submit a claim to vote on the resolution plan or be considered in the resolution process during CIRP or distribution of proceeds during the liquidation process. Failure to submit the claims will result in non-participation, which may have adverse legal effects on such creditors, considering the consequences of the approval of the resolution plan in a CIRP[13] and dissolution of the CD in the liquidation process pursuant to the liquidation of CD's assets.[14] Therefore, the concept of 'claim' incorporated under the Code should consider the collective nature of the insolvency procedures and the participation of creditors. The legislature has adopted a comprehensive definition of 'claims', which covers a broad category of obligations and liabilities of the CD. The definition adopted in the Code is similar to the one adopted in the US Bankruptcy Code.

Further, the process of receipt and collation of claims plays a pivotal role in ascertaining the company's overall financial position. This is relevant for the CIRP as it assists the CoC and the prospective resolution applicant in ascribing a fair value to the CD. In the case of the liquidation process, the submission of a claim is relevant for the Liquidator to classify the claims for distribution of the liquidation estate.

INTERPLAY BETWEEN THE CONCEPT OF 'CLAIM' AND 'DEBT'

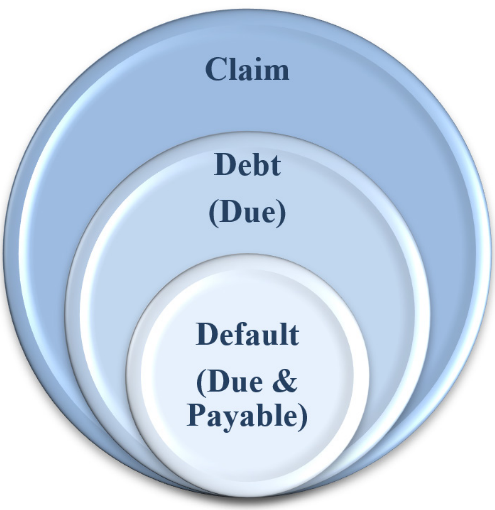
In addition to the concept of 'claim', under Chapter II of Part II of the Code, reference is made to the concept of 'debt'. For instance, section 30, which deals with the submission of a resolution plan, states,

'... each resolution plan- (a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor; (b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than ...' As per section 31 of the Code, an approved resolution plan *'shall be binding on the corporate debtor and its* **...** *creditors, including ... any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed',* ... involved in the resolution plan.

A 'creditor' means any person to whom a debt is owed.[15] Several references are made to the word 'creditor' under the provisions dealing with Chapter II of Part II of the Code. Further, section 53 of the Code also references 'debt' for distribution of the liquidation estate.

In this regard, NCLT in *Esspee Sarees Pvt. Ltd.*[16] observed that *'a claim can be due or not. Unless a claim becomes due only then it gets converted into debt. Further, debt must be due and payable in law or fact for occurrence of event of default. Thus, there is a marked difference between both the terms i.e. 'claim' and 'debt'. Both have got different implications on various aspects/process which are undertaken under the Code'*. The other possible interpretation is that every claim submitted against a CD will amount to a debt owed by the CD; they should be the subject matter of the resolution plan, especially considering the consequences of its approval, i.e. extinguishment of all claims of the CD. For example, under the US Bankruptcy Code, 'debt' is defined as a liability on a claim.[17] Therefore, this interests an inquiry into the difference between the understanding of 'claim' and 'debt' under Chapter II of Part II of the Code.

As discussed above, 'debt' is defined as a liability or obligation in respect of a 'claim' which is due from any person.[18] The phrase 'liability or obligation in respect of' is prefixed to 'claim', broadening the scope of 'claim'. Emphasis is placed on the word 'due' appearing in the definition and the exact meaning of the word 'due' will depend upon the context in which the words appear.[19] Generally, it is interpreted to mean an existing obligation, whether or not required to be performed immediately or a claim that is matured some time in part and yet remains unsatisfied.[20] Therefore, a claim that is due can be understood as an obligation or a liability that is certain, fixed or already in existence, whether or not such obligation is required to be performed immediately or in future.



The interconnectedness of the concepts of 'claim', 'debt' and 'default' under the Code

This paper analyses the scope and nature of the definition of 'claim' under the Code and how it envisages consideration of 'claims' during the CIRP by the Interim Resolution Professional (IRP) or Resolution Professional (RP), and the AA.

UNDERSTANDING OF PROOF OF CLAIMS UNDER OTHER COLLECTIVE INSOLVENCY OR BANKRUPTCY PROCEDURES IN INDIA

A collective insolvency or bankruptcy procedure which requires submission of claims is not new to the Indian legal structure. The law of insolvency in India owes its origin to English Law.[21] Unlike several laws of that era which were preceded by common law jurisprudence, the Bankruptcy Law was purely a creature of statute.[22] In earlier statutes, only certain or absolute debts were provable in bankruptcy,[23] and the class of provable debts enlarged from time to time.[24]

Before enactment of the Code, the Companies Act, 2013 and its predecessor provided for the types of debts that can be admitted as proof during the winding up of a company.[25] Section 325 of the Companies Act, 2013 (Section 528 of the Companies Act, 1956) provided that for winding up of insolvent companies, rules contained in the Presidency-Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 (collectively referred to as 'personal insolvency laws') shall apply *inter alia* about the debts provable and valuation of annuities and future and contingent liabilities.

Under the personal insolvency laws, a creditor who wishes a share in the distribution must prove his debt in the prescribed modes. A broad category of debts and liabilities in respect of which creditors are entitled to share in the distribution of the assets is called 'debts provable in insolvency'. The method by which they are established is called 'proof of debts'.[26] All debts and liabilities, present or future, certain or contingent, are deemed to be debts provable in insolvency.[27] Debts and liabilities not provable in insolvency included the (i) demands in the nature of unliquidated damages arising otherwise than by reason of a contract or breach of trust, (ii) contingent debts and liabilities, the value of which cannot be fairly estimated.[28]

With a broad class of obligations and liabilities that can be proved, the companies law regime and the personal insolvency laws ensured that all stakeholders with claims against the debtor could submit proof to participate in its insolvency or bankruptcy procedures. Although the concept 'debts provable or not provable in insolvency' was not extended under the Code, the inclusion of a broad definition of 'claims' suggests that the legislative intent was to allow submission and treatment of all obligations and liabilities during the insolvency proceedings of the CD.

Insolvency Claims under UK Law

Where a creditor intends to participate in the winding-up or administration of a company in the United Kingdom (UK), it must submit admissible or provable claims. Proving ensures that the Administrator and the Liquidator have information about the company's debts. This is useful for different purposes during the company's winding-up or administration proceedings, including determining creditors' voting rights, calculating the amount of any dividend and the distribution to be paid to each creditor, and working out the priority of creditor claims.[29]

The claims which may be proved in the winding-up or administration of the company are provided in the Insolvency (England and Wales) Rules, 2016 and, in principle, comprise all debts and liabilities to which the company was subjected at the date on which it went into winding-up or entered administration or to which it may have become subject after this date in consequence of an obligation incurred before this date.[30] Generally, all claims by creditors, except as provided otherwise,[31] are provable as 'debts' against the company or bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages.[32]

'Debt' about the winding-up and administration means - [33] (a) any debt or liability to which the company is subject at the relevant date; (b) any debt or liability to which the company may become subject after the relevant date by reason of any obligation incurred before that date; and (c) any interest specifically provable as per the rules.[34] Liability in tort will be provable in the winding up or administration if all the elements necessary to establish the cause of action exist at the relevant date (the date the company went into administration unless the administration was immediately preceded by a liquidation, in which case it is the date on which it went into liquidation). There is no need for actional damage to have been suffered by that date.[35]

Further, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, whether its amount is fixed or liquidated, or can be ascertained by fixed rules or as a matter of opinion.[36] Also, liability is widely defined as a liability to pay money, or money's worth, including any liability under an enactment, liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.[37]

A creditor must submit a proof of debt to the Administrator or the Liquidator by the procedural requirements stipulated under the Insolvency (England and Wales) Rules, 2016.[38] In the UK, the winding-up or the administration proceedings can precede each other. A creditor is deemed to have proved in an administration immediately preceded by a winding up, where the creditor has already proved in the winding up and *vice versa*.[39] The Administrator or the Liquidator may admit or reject the proof either in whole or part.[40] While rejecting the proof, the Administrator or the Liquidator must provide reasons for doing so as soon as reasonably practicable.[41] If a creditor is dissatisfied with the rejection of proof, it may apply to the court for the decision to be reversed or varied.[42]

In the administration or winding-up proceedings, the Office-holder must estimate the value of a debt that does not have a certain value because it is subject to a contingency or any other reason.[43] It also applies to unliquidated claims for damages.[44] This estimation can be revised due to the changes in circumstances or any information available to the Administrator or Liquidator.[45] For instance, the probability of a contingency occurring can be considered.[46] It is required to place a fair and reasonable value upon the claim, but a nil value may be attached where there is uncertainty as to whether or not the relevant contingency will be satisfied.[47] The valuation of a contingent liability should be based on a genuine and fair assessment of the chances of the liability occurring, as an assessment is required to be made of how likely the chances of the event occurring.[48] The officer-holder can make a reference to the court for its directions,[49] and an appeal against the estimation can also be made.[50]

The Insolvency (England and Wales) Rules, 2016 also provide for the manner of dealing with future debts.[51] The future debt covers demands that have not become due and payable at the commencement of the winding-up or administration proceedings. For instance, proof of liabilities like annuities or periodical payments. In such cases, the dividend is discounted at the rate of 5% per annum, compounded yearly, for the period between the relevant date (date on which the insolvency proceedings commence) and the date when payment of the debt would otherwise be due.[52]

Insolvency Claims under US Laws

A broad definition of 'claim' is adopted by the US Bankruptcy Code.[53] The definition of 'claim' under the Code is similarly structured to 'claim' under the US Bankruptcy Code. The US Bankruptcy Code defines the term 'claim' as any right to payment or the right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not the right to payment is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.[54] The courts have interpreted this definition as the broadest to permit the most comprehensive relief in the bankruptcy case.[55]

The phrase 'right to payment' has been interpreted to mean an obligation enforceable against the debtor and property of the debtor that exists as of the petition date.[56] Also, in some instances, 'right to an equitable remedy' whether or not it is fixed, disputed, or reduced to judgment is included. However, a claim will not arise where the breach cannot give rise to a payment obligation but only requires non-monetary action by a debtor. The inclusion of such remedies that may be reduced to payment has two purposes: to ensure that claims that are uncertain and difficult to estimate can be adjudicated in a bankruptcy case and to achieve finality in bankruptcy cases.[57]

In a Chapter 11 reorganisation proceedings, the claims forming part of the schedule of liabilities filed by the debtor are deemed to be submitted, as long as the debtor doesn't list such claims as disputed, contingent or unliquidated.[58] The scheduled claims are allowed in the amounts listed unless the creditor files a superseding proof of claim, or the listed claim is objected to by a party in interest.[59] In a Chapter 7 liquidation proceedings, the creditor can file proof of claims. The debtor or party in interest can object to a claim, and the bankruptcy court has a duty to consider the issues raised related to the disputed claims.[60] The trustee is primarily responsible for objecting to the claims in Chapter 7 liquidation proceedings.[61] Similarly, in a Chapter 11 proceedings, a trustee is appointed upon a showing of cause, including fraud or gross mismanagement by the debtor. It is responsible for examining and objecting to the proof of claims.[62]

The bankruptcy courts in the US have a general jurisdiction (*in rem*) to supervise the administration of the bankruptcy estate, including the exclusive jurisdiction to determine allowance and disallowance claims against the estate.[63] Where an objection is made to the claim, the bankruptcy court can enter a final judgment resolving the dispute.[64] It is suggested that the jurisdiction granted to the bankruptcy court is equitable in nature and is required to resolve which parties are entitled to a distribution from the property which the bankruptcy court holds in *custodia legis.*[65]

The bankruptcy court is authorised to establish a special procedure for estimating claims, where the liquidation of such claims will unduly delay the administration of the case.[66] However, the courts generally favour liquidating the amount of claims rather than estimating the same.[67] The estimation of a claim can occur if the following conditions are met: (1) the claim is unliquidated; (2) the claim is contingent, and (3) fixing the amount of the claim must entail undue delay in the administration of justice.[68] A court can also estimate a right to equitable remedy for breach of performance, but only if the right give rise to a right to payment.[69] It is suggested that estimation has two purposes – (1) to avoid the need to await the resolution of outside lawsuits to determine issues of liability or amount owed by means of estimating the likely outcome of the action; and (2) to promote a fair distribution to creditors through a realistic assessment of uncertain claims.[70]

The courts exercise broad discretion in valuing the claims. However, no procedure is prescribed for the same and the method that best suits the circumstances is used. It has been observed that the courts may use any method that is best suited to the contingencies of the case, so long as the procedure is consistent with the fundamental policy of Chapter 11 that a reorganisation must be accomplished quickly and efficiently.[71] There are different approaches to the reliance on the estimations. Some courts believe that estimation would only be used for determining the creditor's 'voice' in the Chapter 11 case and would be subject to modification pending the conclusion of litigation.[72] At the same time, others have observed that the determination of the estimated amount is conclusive for allowability.[73] In this regard, the lack of procedures and standards is unfortunate and creates an enormous lack of predictability when an estimation hearing is done.[74]

ANALYSIS OF THE DEFINITION OF 'CLAIM' UNDER THE CODE

As per section 3(6) of the Code, the term 'claim' is defined as follows -

> "claim" means –
>
> (a) <u>a right to payment</u>, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured, or unsecured;
>
> (b) <u>right to remedy for breach of contract</u> under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured.

The definition of 'claim' is divided into two parts - clause (a), which covers a right to payment, and clause (b), which covers a right to remedy for breach of contract. Clause (a) ensures that a creditor can file claims against the monetary obligations and liabilities of the CD. Correspondingly, clause (b) ensures that different rights to remedy arising from the breach of contract under any law can be treated as claims in the insolvency proceedings. The right under clause (b) is only considered a 'claim' if the breach gives rise to a right to payment. Further, to avoid ambiguity, this provision clarifies the nature of rights that will be covered under the scope of claims.

A broad category is included for clauses (a) and (b), reiterating that a wide range is ascribed to this provision. It is interesting to note that the nature of the rights is provided in pairs or concepts which are relatable to each other in the common law jurisprudence—for instance, disputed-undisputed, legal-equitable, matured-unmatured. However, the concepts 'reduced to judgment' and 'fixed' are used without pairs. This raises an ambiguity as to whether the opposite of these concepts is covered or not. For instance, a fixed right can be understood as a definite or settled or unchanging right, and it may be argued that a contingent right is intentionally excluded. As stated above, the definition of claims and its structure is similar to the definition of claims under the US Bankruptcy Code, where under the concept of 'fixed' seems to be paired with 'contingent'.[75] However, the concepts stipulated in this definition should be read with the phrase 'whether or not', which essentially means that either of the concepts is intended to be included. Therefore, if 'fixed' is included, then the rights that are not 'fixed' are also intended to be within clauses (a) and (b).

Further, a doubt may arise as to the need for clause (b), as the same can be covered under clause (a), which itself provides for a broad class of the right to payment or whether clause (b) is a subset of clause (a). Even though the factual scenario in which a claim under clause (b) can arise may be the same as clause (a), the two clauses define distinct types of claims.

For instance, if X and Y enter into a contract for the sale of antiques which are limited in number, and after the payment by X, Y refuses to supply the antiques, then X is entitled to recovery of those antiques through specific performance. Alternatively, X has the option to seek damages by the terms of the contract or compensation under the Indian Contract Act, 1872. The remedy of specific performance will fall under clause (b), and the right to seek damages will fall under clause (a). Each claim is different though the basis of each claim (i.e. the breach of contract) is the same. However, if the breach of contract by Y does not give rise to a right to payment, a claim under clause (b) cannot be made. For example, suppose a contract expressly excludes the right to claim damages (i.e. a right to payment), even though the right to seek specific performance exists. In that case, the same may not be categorised as a claim for this definition.

Clause (b) refers to the right to remedy for breach of a contract. Under section 73 of the Indian Contract Act, 1872, where a breach of contract results in loss or damage, the party who suffers can seek compensation. Therefore, in most cases, the right to payment under the breach of contract will always be there. Contracts may exclude the right to claim damages by an express clause. However, such contractual clauses may be interpreted as contrary to section 23 (opposed to public policy) or section 28 (restraint of legal proceedings) of the Indian Contract Act, 1872.[76]

The analysis of the scope of the definition of 'claims' as envisaged under the Code suggests that the nature of claims submitted during the CIRP (and liquidation proceedings) can be both determinable and indeterminable. A broad category of claims ensures that all types of creditors get an opportunity to submit their claims for due consideration during the CIRP and to establish their voting rights in the case of financial creditors.

Consideration of Claims during CIRP

Once the application for initiation of CIRP is admitted, a moratorium is issued, and a public announcement of the CIRP is made along with the call for submission of claims.[77] The public announcement also provides the last date for submission of claims.[78] After that, different types of creditors file claims with proof under Chapter IV of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons), 2016 (CIRP Regulations). The Code prescribes that the IRP is required to receive and collate all the claims submitted by creditors to him.[79] After collation of the claims received and determination of the financial position of the CD, the IRP is required to constitute a committee of creditors (CoC).[80]

The literal interpretation of these provisions suggests that the IRP must perform two types of actions concerning the claims - (i) receive the claims and (ii) collate the claims. The legislature has consciously used 'collate' or 'collation' under the Code's provisions rather than collect or collection. As per the Oxford Dictionary, 'collate' means to collect information together from different sources in order to examine and compare it.[81] Once the IRP receives the claims; he is not required to merely collect the same and form the CoC based on whatever is received. Instead, the IRP is required to examine the claims and compare them with the financial information received from the CD. Further, under section 21(1) of the Code, before forming the CoC, IRP is also required to determine the financial position of the CD. Therefore, examining claims during the CIRP stage becomes more relevant when seen in this background.

This clearly shows that the role of the IRP in relation to the claims, as envisaged under Chapter II of Part II of the Code, entails the application of mind for determining the actual status of the claims *vis-a-vis* the CD. In furtherance of the same, Chapter IV of the CIRP Regulations has laid down the requirement of determination and verification of the claims, which must be understood in the light of the role of the IRP as envisaged under the Code. Further, the RP is required to maintain an updated list of claims during the CIRP, specifically providing for amounts claimed *vis-a-vis* amounts admitted.[82] In addition, as per the CIRP Regulations, a list of creditors must be maintained.[83] The same also forms part of the information memorandum, a key document based on which resolution plans are received.[84]

The nature of powers and functions performed by the IRP and RP during CIRP has been a subject matter of litigation in several courts and tribunals. The Supreme Court in *Swiss Ribbons* [85] held that the RP is a facilitator of the resolution process, whose administrative functions are overseen by the CoC and AA. It noted that, unlike the Liquidator, the RP could not act in several matters without the approval of the CoC under section 28 of the Code, and the CoC can replace him with a two-thirds majority. It has also been observed that RP has no jurisdiction to 'determine' the claim and can only 'collate' the claim based on the evidence and record of the CD.[86]

The categorisation by the Supreme Court determines the nature of the decision-making power of the IRP/RP. This should not be interpreted to limit the duty required by the IRP/RP during the CIRP. The IPs who perform the role of IRP/RP are regulated by the Insolvency and Bankruptcy Board of India (IBBI). The IBBI lays down the standards of conduct for the professional services rendered by the IPs during the processes under the Code. The determination made by a professional like an IP may be administrative or facilitative in nature, and it is up to the person filing the claim to accept the same or not.

If the same is not acceptable, he can approach the NCLT under section 60(5) of the Code. AA has the inherent power to supervise the decision of IRP/RP and to go into the details of the claim made and, after that, examine the correctness of adjustment, if any, made by the RP and finally pronounce its decision.[87] Further, section 60(5)(b) enables the AAs to dispose of claims made by or against a CD. The residuary jurisdiction of the AA under section 60(5)(c) of the IBC provides it with a wider discretion to adjudicate questions of law or fact arising from or in relation to the insolvency resolution process. However, while exercising its jurisdiction, it must not exercise jurisdiction over matters that dehors the insolvency proceedings.[88]

In this background, IRP or RP should appreciate their duty to estimate the claim amount under regulation 14 of the CIRP Regulations. Accordingly, given the power under this regulation, the IRP/RP must not *prima facie* reject the value of the contingent claims. Instead, they should apply their minds to estimate such claims' notional value and not reject them merely because they are not determined or assign a value of ₹ 1 due to the pendency of adjudication.[89]

Impact of Approval of Resolution Plan on Claims

Once a resolution plan is approved, it is deemed that all claims pending against the CD are settled by way of the resolution plan, whereby further claims cannot be entertained against the CD. Section 31 provides that an approved resolution plan is binding on the CD and its employees, members, creditors, guarantors and other stakeholders. The legislative intent behind this is to ensure that after the approval of the resolution plan, the successful resolution applicant (SRA) should not face any surprise claims. Also, once the resolution plan is approved, the AA has limited jurisdiction and should not interfere with the commercial wisdom of the CoC. The AA is not expected to substitute its view with the unanimous commercial decision of the CoC, nor should it deal with the technical complexity and merits of the resolution. The role of the CoC is vital for deciding the fate of the company, and the AA is not required to look into the merits or reasoning of the decision taken by the CoC for approval or rejection of the resolution plan.[90]

The objective is that the SRA must start on a fresh slate based on the resolution plan, which is backed by the commercial wisdom of the CoC. Accordingly, on approval of a resolution plan, the claims as provided in the resolution plan stand frozen, and their treatment in the resolution plan is binding on all stakeholders. The Supreme Court in Essar Steel has observed that –

> ...successful resolution applicant cannot suddenly be faced with "undecided" claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the CD. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the CD. This the successful resolution applicant does on a fresh slate…[91]

This also has the effect of extinguishing all other claims not part of the resolution plan. Further, in another matter, the Supreme Court has observed that, *'all the dues including the statutory dues owed to the Central Government, any State Government or any local authority, if not part of the resolution plan, shall stand extinguished and no proceedings in respect of such dues for the period prior to the date on which the AA grants its approval under section 31 could be continued.'* [92] Accordingly, claims that are not submitted or are not accepted or dealt with by the RP while approving the resolution plan may get extinguished upon the approval of the resolution plan by the AA, unless otherwise provided in the resolution plan.[93]

CONCLUSION

Gauging the contours of the above discussion, the concepts of 'claim', 'debt' and 'default' play a very substantive role in understanding different provisions of the Code. The Code incorporates a comprehensive definition of 'claims', including determinable and indeterminable rights. It is not limited to the monetary obligations of the CD. Such an approach is essential for ascertaining a fair market value of the CD and consideration of all the claims against the CD. The admission of the application for initiation of the process can be understood to acerates accelerate the claims, even if they are unmatured, unliquidated and contingent, because the claims get extinguished after approval of the resolution plan.

The types of claims admitted during the CIRP should not be restricted by the limitations in the claim consideration process. Instead, the regulatory model and timelines for claims consideration should be commensurate with the comprehensiveness of the concept of 'claim' under the Code. In practice, IRP or RP must assign a fair and reasonable value to all the claims received against the CD for consideration in the resolution plan or determining the financial position of the CD. For this purpose, the regulatory model should account for a methodology for valuing different types of claims, and IRP/RP should not reject them for being indeterminable and uncrystallised. In addition, the regulatory model can integrate the role of professional Valuers with the claim consideration process to ensure efficiency.

The objective of the Code to resolve insolvency in a time-bound manner for value maximisation coupled with the development of the clean slate theory requires the CIRP to strike a balance between efficiency and legitimacy. As we advance, the lack of a robust mechanism and practice for claim consideration during CIRP may stifle its legitimacy and affect the concretisation of the clean slate theory. A more detailed set of provisions are required to clarify how to deal with the uncertain claims, including the contingent claims or future claims during the CIRP and strengthen the claims consideration process. Learnings from a jurisdiction like the UK and USA may be considered as they classify broad types of debt or claims for consideration in insolvency and bankruptcy procedures. Their regulatory model also provides special procedures for claim consideration to support such claims (including contingent and future claims). In addition to the provision for claim consideration, these practices help achieve finality in insolvency or bankruptcy cases.

*These are personal views of the authors. They do not reflect the views of the organisation with which they are affiliated.

[1] Hogg M. (2017), "Obligations Law and Language", *Cambridge University Press*, p.12.
[2] Section 2(6) of the Code.
[3] Section 2(11) of the Code.
[4] Para 27 of the UNCITRAL Legislative Guide.
[5] Para 23 of the UNCITRAL Legislative Guide.
[6] Para 25 of the UNCITRAL Legislative Guide.
[7] Para 4-01 of Goode on Principles of Corporate Insolvency Law, 5th Edition.
[8] Para 5.2.2. of the BLRC - Several jurisdictions have balance sheet tests as one element to determine insolvency. Another is the presentation of reasoned arguments for why the entity should be considered insolvent. These too are based on performance in balance sheets and cash-flow statements of the entity. The balance sheet test is vulnerable to the quality of accounting standards. India suffers from having both a low average standard of accounting quality as well a wide variation across single entities. Therefore, the Code does not prescribe fixed balance sheet variables or parameters as critical to triggering insolvency.
[9] Para 5.2.2. of the BLRC.
[10] Para 5.2.2. of the BLRC.
[11] Sections 7, 9 and 10 of the Code; Notification No. S.O. 1205(E) dated March 24, 2020 issued by the Ministry of Corporate Affairs.
[12] Section 13 of the Code.
[13] The Supreme Court of India in *Ghanashyam Mishra v. Edelweiss*, 2021 SCC Online SC 313, held that upon approval of the resolution plan, all claims which are not part of the plan stand extinguished.
[14] The liquidation process results in dissolution of the company under section 54 of the Code.
[15] Section 3(10) of the Code.
[16] *Esspee Sarees Pvt. Ltd. v. Skipper Textiles Pvt. Ltd.* CA(IB) No.1328/KB/2019 and CP(IB) No. 1702/KB/2019
[17] Section 101(12), Chapter 11, The U.S. Code.
[18] Section 2(11) of the Code.
[19] *State of Kerala v. V.R. Kalliyanikutty*, (1999), 3 SCC 657
[20] P Ramanathan Aiyar's, Advanced Law Lexicon 5th Edition, Lexis Nexis - Meaning of the word 'due'.
[21] The Twenty-Sixth Report on Insolvency Laws, Law Commission of India, February 1964, para 2.
[22] *Ibid.*
[23] Para 428. Lecture 7, Part 3 - Proof of Debts. Tagore Law Lectures, 1929 - Law of Insolvency in British India by Sir Dinshar Fardunji Mulla, Kt.
[24] *Ibid.*
[25] Section 324 of the Companies Act, 2013 (Section 528 of the Companies Act, 1956) provides that the debts of all descriptions be admitted to proof except for insolvency companies.
[26] Para 427, Lecture 7, Part 3 - Proof of Debts. Tagore Law Lectures, 1929 - Law of Insolvency in British India by Sir Dinshar Fardunji Mulla, Kt.
[27] Section 46 of the Presidency Towns Insolvency Act, 1909 and Section 34 of the Provisional Insolvency Act, 1929.
[28] Section 46 of the Presidency-Towns Insolvency Act, 1909 and Section 34 of the Provisional Insolvency Act, 1929; Sir Mulla D. F., "Mulla The Law of Insolvency in India", 6th Edition (Ed. Aparna Ravi), para 415 and p. 359; Tagore Law Lectures, 1929 - Law of Insolvency in British India by Sir Dinshar Fardunji Muli-A, Kt. - Under the Presidency-Towns Insolvency Act, 1909, an additional class of debts and liabilities were not provable in insolvency, being debts or liabilities contracted by the debtor with any person, after that person has had notice of the presentation of any insolvency petition by or against the debtor. This exclusion is not made under Provincial Insolvency Act, 1929. The effect is that a debt or liability falling within this category is provable under that Act. Further, besides these debts certain debts were not provable by the general policy of the law as they cannot be enforced by action. For instance, illegal or immoral consideration, gaming debts, contract against the policy of the bankruptcy laws, secret agreement to give preference to a creditor, agreement in fraud of other creditors, debts barred by limitation.
[29] Proofs of Debts in Liquidation and Administration: Overview, Practical Law Restructuring and Insolvency.
[30] Edward Bailey and Hugo Groves, Corporate Insolvency - Law and Practice, 4th Edition, 2015, p.1182 and para 26.1.
[31] Under rule 14.2(2) of the Insolvency (England and Wales) Rules, 2016 some claims are not provable including obligations arising under a confiscation order made in a certain enactment. Further, rule 14.2(5) preserves the validity of any independently established rule of law or enactment under which a particular kind of debt is not provable, whether on grounds of public policy or otherwise. As per Ian F. Fletcher, The Law of Insolvency, Sweet and Maxwell, 5th Edition - This sweeping, if un-specific, provision has the effect of excluding from the category of provable debts any debt or liability, established or alleged, which lacks the essential characteristic of being legally enforceable against the bankrupt as at the date of commencement of bankruptcy.
[32] Rule 14.2 of the Insolvency (England and Wales) Rules, 2016.
[33] Rule 14.1(3) of the Insolvency (England and Wales) Rules, 2016.
[34] Rule 14.23 of the Insolvency (England and Wales) Rules, 2016.
[35] Rule 14.1(4) of the Insolvency (England and Wales) Rules, 2016.
[36] Rule 14.1(5) of the Insolvency (England and Wales) Rules, 2016.
[37] Rule 14.1(6) of the Insolvency (England and Wales) Rules, 2016; Goode R., "Goode on Principles of Corporate Insolvency Law, 5th Edition, para 8-45.
[38] Rule 14.3(1) of the Insolvency (England and Wales) Rules, 2016.
[39] Rule 14.3(2) of the Insolvency (England and Wales) Rules, 2016.
[40] Rule 14.7 of the Insolvency (England and Wales) Rules, 2016.
[41] *Ibid.*
[42] Rule 14.8 of the Insolvency (England and Wales) Rules, 2016.
[43] Rule 14.14(1) of the Insolvency (England and Wales) Rules, 2016.
[44] Goode R., "Goode on Principles of Corporate Insolvency Law", 5th Edition, para 8.47.
[45] Rule 14.14(2) of the Insolvency (England and Wales) Rules, 2016.
[46] Goode R., "Goode on Principles of Corporate Insolvency Law", 5th Edition, para 8.43.
[47] McPherson's Law of Company Liquidation, 4th Edition, para 12-023; Re Lehman Brothers International (Europe) (in administration) [2012] EWHC 2997 (Ch) at [41]. Also, according to McPherson's Law of Company Liquidation 4th Ed. – If the contingency happens during winding up, the creditor is entitled to prove for the

actual amount; if proof has already been lodged, the creditor will be permitted to withdraw and amend it accordingly, though not so as to disturb dividends already paid. The effect is not to convert the claim into a debt for the purpose of proof: it remains a contingent claim, but the happening of the contingency is treated as admissible evidence of its actual value at the time winding up started.

48 McPherson's Law of Company Liquidation 4th Edition, para 12-023; 185 Re Danka Business Systems Plc [2013] EWCA Civ 92; [2013] B.C.C. 450; [2013] B.P.I.R. 432.

49 Rule 14.14(4) of the Insolvency (England and Wales) Rules, 2016 read with section 168(3) of the Insolvency Act, 1986.

50 Section 168(5) of the Insolvency Act, 1986.

51 Rule 14.44 of the Insolvency (England and Wales) Rules, 2016 provides that –
Debt payable at future time—(1) Where a creditor has proved for a debt of which payment is not due at the date of the declaration of a dividend, the creditor is entitled to the dividend equally with other creditors, but subject as follows.
(2) For the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof must be discounted by applying the following formula—$X/1.05^n$, where— (a) "X" is the value of the admitted proof; and (b) "n" is the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due, expressed in years (part of a year being expressed as a decimal fraction of a year).

52 Kerr & Hunter on Receivers and Administrators, 21st Edition, para 25-111.

53 Section 101(5) of the US Bankruptcy Code.

54 *Ibid.*

55 Hon. Feeney J. N. et al., "Bankruptcy Law Manual", 5th Edition, Chapter 6 - Creditors and claims, 6.4; Section 101(5), Chapter 11, The U.S. Code.

56 *Ibid.*

57 *Ibid.*

58 Kilborn J., "National Report for the United States, Ranking and Priority of Creditors", Oxford International & Comparative Insolvency Law, para 19.21.

59 *Ibid.*; Section 502(a), 11 U.S.C.A.

60 Section 502(a), 11 U.S.C.A. ; *see* Proof of Claim Litigation, Bankruptcy Litigation, 10:40.

61 Proof of Claim Litigation, Bankruptcy Litigation, at 10:40 – Section 502 states that objections can be prosecuted by any party in interest, but the trustee has an affirmative statutory obligation under § 704(5) to prosecute objections to claims whenever the prosecution of such objections will serve a useful purpose. … The trustee's primary obligation is to administer the assets of the bankruptcy estate. Administration of the assets includes liquidation of the assets and distribution of the proceeds from that liquidation to the parties entitled to receive such distribution. To determine which parties are entitled to share in the distribution, the trustee must review the proofs of claim filed by creditors and object to those claims which appear to be objectionable. … The trustee is obligated to object to claims only "if a purpose would be served ...." No such purpose is served in no asset bankruptcy proceedings, because no distribution is made to any creditor in such cases. There is no need to determine who would be entitled to a pro-rata distribution if there is nothing to distribute on a pro-rata basis.

62 Proof of Claim Litigation, Bankruptcy Litigation.

63 Proof of Claim Litigation, Bankruptcy Litigation.

64 Section 157(b)(2)(B), 28 U.S.C.A.

65 Proof of Claim Litigation, Bankruptcy Litigation

66 Section 502(c), The U.S. Bankruptcy Code.

67 Proof of Claim Litigation, Bankruptcy Litigation.

68 Section 502(c), 11 U.S.C.A.

69 *Ibid.*

70 *Matter of Continental Airlines*, 981 F.2d 1450, 1461, 28 Collier Bankr. Cas. 2d (MB) 538, 142 L.R.R.M. (BNA) 2398, 124 Lab. Cas. (CCH) 10595 (5th Cir. 1993).

71 *In re Adelphia Business Solutions, Inc.,* 341 B.R. 415, 422 (Bankr. S.D. N.Y. 2003); *In re Windsor Plumbing Supply Co., Inc.*, 170 B.R. 503, 520 (Bankr. E.D. N.Y. 1994) – The methods used by courts have run the gamut from summary trials to full-blown evidentiary hearings to a mere review of pleadings, briefs, and a one-day hearing involving oral argument of counsel.

72 *In re Chateaugay Corp.,* 944 F.2d 997, 1006, 22 Bankr. Ct. Dec. (CRR) 74, 25 Collier Bankr. Cas. 2d (MB) 620, 34 Env't. Rep. Cas. (BNA) 1233, 21 Envtl. L. Rep. 21466 (2d Cir. 1991); *Bittner v. Borne Chemical Co., Inc.*, 691 F.2d 134, 137, 9 Bankr. Ct. Dec. (CRR) 1065, 7 Collier Bankr. Cas. 2d (MB) 376 (3d Cir. 1982); In *re Lane*, 68 B.R. 609, 613 (Bankr. D. Haw. 1986); Proof of Claim Litigation, Bankruptcy Litigation, at 10:40

73 *In re Wallace's Bookstores, Inc.*, 317 B.R. 720, 725, R.I.C.O. Bus. Disp. Guide (CCH) P 10726 (Bankr. E.D. Ky. 2004); *In re C. F. Smith & Associates, Inc.*, 235 B.R. 153, 160, 76 Empl. Prac. Dec. (CCH) P 46159 (Bankr. D. Mass. 1999); *In re MacDonald,* 128 B.R. 161, 167 (Bankr. W.D. Tex. 1991); Proof of Claim Litigation, Bankruptcy Litigation.

74 Proof of Claim Litigation, Bankruptcy Litigation.

75 Section 101(5), 11 U.S.C.A. -
(5)The term "claim" means—
(A)right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
(B)right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

76 Pollock & Mulla: The Indian Contract Act, 16th Edition, para s 73.4.1; *Simplex Concrete Piles (India) Ltd v. UOI*, 2010 SCC Online Del 821 wherein the Delhi High Court observed that a contract that wholly excludes the rights flowing from section 73 would be opposed to public policy. In this regard, Pollock & Mulla noted that the court did not consider section 62 of the Sales of Goods Act, 1930 which provides that where any right, duty or liability would arise under a contract of sale by implication of law, it may be negated by express agreement between the parties. It observed that - Delhi High Court's decision that a contractual clause excluding damages for breach would be against public policy appears too wide in the light of the judgments holding that damages cannot be awarded when the contract provided that in case of delay in handing over possession of site to contractor or delay due to any other cause, the contractor was entitled only to extension of time for completion of the contract but not to compensation or damages.

77 Section 13 of the Code.

78 Section 15(1)(c) of the Code.

79 Section 18(1)(b) of the Code.

80 Section 21(1) of the Code.

81 Hornby A.S., Oxford Advanced Learner's Dictionary of Current English, 10th Edition, p.291; the Wharton's Concise Law Dictionary wherein 'collation' is defined as the comparison of a copy with its original to ascertain its correctness; or the report of the officer who made the comparison.

82 Section 25(1)(e) of the Code and Regulation 13(1) of the CIRP Regulations.

83 Regulation 13 of the CIRP Regulations.

84 Regulation 36 of the CIRP Regulations.

85 *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*, Civil Appeal No. 99 of 2018 and other petitions.

86 *Mr. S. Rajendaran, Resolution Professional of PRC International Hotels Private Limited v. Jonathan Mouralidarane*, CA (AT)(Ins)1018/2019

87 *Navneet Kumar Gupta v. Bharat Heavy Electrical*, 2019, 287 NCLAT.

88 *Tata Consultancy Services Ltd. v. Vishal Ghisulal Jain*, Civil Appeal No 3045 of 2020

89 *Committee of Creditors of Essar v. Satish Kumar Gupta*, 2019, Civil Appeal No. 8766-67 of 2019.

90 *K. Shashidhar v. Indian Overseas Bank*, 2019 152 SCL 312

91 *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, 2020 8 SCC 531.

92 *Ghanashyam Mishra and Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Company Ltd. & Ors.*, Civil Appeal No. 8129 of 2019 with WP (Civil) No. 1177 of 2020 and other appeals.

93 For instance, in certain cases contingent claims are categorized separately under the resolution plan and a specific value is attached to such claims. See *JSW Steel Ltd. v. Mehendra Kumar Khandelwal & Ors.*, 2020, CA (AT) (Insolvency) No. 957 of 2019; *Shaji Purushothaman v. S Rajendran & Ors.*, 2020, CA(AT) (Insolvency) No. 551 of 2020.

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TO ADJUDICATE OR NOT ADJUDICATE:

CONFLICT OF JURISDICTION BETWEEN NCLT AND CIVIL COURTS

— Bahram N. Vakil, Suharsh Sinha and Saloni Thakkar

Executive Summary

The National Company Law Tribunal (NCLT) has been granted extensive powers to adjudicate issues linked to the corporate insolvency resolution processes (CIRP) of corporate debtors (CD). This Paper seeks to analyse the position with respect to the residuary jurisdiction of the NCLT under the Insolvency & Bankruptcy Code, 2016 (IBC / Code).

The IBC has a non-obstante clause and confers jurisdiction to the NCLT to deal with - (a) any applications by or against the CD / corporate person; (b) claim by or against the corporate debtor / corporate person, including claims by / against any of its subsidiaries in India; and (c) any question of priorities or of law or facts, in relation to the CIRP. Further, the IBC bars the ordinary jurisdiction of civil courts to entertain any suit / proceedings in respect of any matter over which NCLT has jurisdiction.

Conjunctively read, these provisions grant the NCLT with exclusive jurisdiction over all proceedings / claims by or against a corporate debtor. However, various court orders have led to conflicting interpretations as to the extent of these sections, which we have sought to analyse.

In the Research Paper, we have identified the approaches adopted in certain foreign jurisdictions, such as UK and USA, and also contrasted with the approaches of the Indian courts. We have evaluated the strengths and weaknesses of these approaches and concluded with the approach which may be considered for India.

Keywords : NCLT Residuary Jurisdiction, NCLT Exclusive Jurisdiction, Adjudication of 'Connected With' Disputes.

INTRODUCTION

This paper aims to explore the width of the jurisdiction of the NCLT with respect to matters connected with the CIRP of a CD, including its assets, etc. This paper also reviews the extant legal position in India in comparison with the position in foreign jurisdictions of US, UK and the position adopted by the United Nations Commission on International Trade Law (UNCITRAL), with the aim to understand the contours of such jurisdiction.

LEGISLATIVE ANALYSIS

The Companies Act, 2013 (Companies Act) vests with the NCLT, the exclusive right to exercise and discharge such powers and functions conferred to it under the Companies Act or any other law, including the IBC.[1] Explicit provisions in regard to the same can be seen in sections 430 and 408 of the Companies Act. Section 430 of the Companies Act, in line with which section 63 of the IBC stands, bars the jurisdiction of civil courts regarding subject matters that come within the purview of adjudication by the NCLT and the National Company Law Appellate Tribunal (NCLAT), and section 408 of the Companies Act vests the NCLT with the right to exercise and discharge such powers and functions conferred to it under the Companies Act or any other law, including the IBC.

Specific provisions in regard to the exclusive jurisdiction of benches of the NCLT are enlisted in sections 60(1) and 60(5) of the IBC. With regard to the territorial jurisdiction of the NCLT, section 60(1) of the IBC provides that, the relevant bench of the NCLT, where the registered office of the corporate person is located, shall have territorial jurisdiction in regard to insolvency resolution and liquidation.

Further, the NCLT also has residuary jurisdiction under section 60(5) of the IBC, which allows it to consider '*all questions of law or fact arising out of or in relation to the corporate debtor's insolvency resolution or liquidation under IBC*'.[2] The court also observed that section 60(5), starting with a non-obstante provision, ensures that the NCLT alone has jurisdiction to decide applications and procedures by or against a CD, indicating that no other body has the power to hear such applications or processes.

The Bankruptcy Law Reforms Committee (BLRC) in its November, 2015 Report delineated its vision of the jurisdiction of courts with regard to issues arising out of and relating to insolvency. The BLRC referred to the NCLT as the forum with jurisdiction over the winding up and liquidation of companies and recommended that original jurisdiction over all matters *vis-à-vis* insolvency should vest with the NCLT. The recommendation of the BLRC was based upon concerns of maintaining the sanctity of the bankruptcy process and to maintain efficiency. The BLRC was also of the opinion that all fresh suits and petitions, ranging from questions of priorities to questions of laws and facts, wherever concerned with the bankruptcy process against the CD must exclusively be entertained by the NCLT. With the overriding effect of the IBC via sections 14 and 238, the recommendation of the BLRC effectively gave a clear mandate to the NCLT via sections 60(3) and 60(5) of the IBC.

INDIAN JURISPRUDENCE

The Supreme Court, in *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta*[3] (Gujarat Urja case), while upholding the decision of the NCLT, held that the residuary powers of the NCLT under the IBC are limited, and it can adjudicate on disputes arising out of contractual matters solely if it is in relation to the resolution process of the CD.[4] The dispute therein was pertaining to an *ipso facto* provision (for termination of the contract on an event of default, which included the admission to insolvency).

Gujarat Urja had entered into a power purchase agreement (PPA) with Astonfield Solar Field (Gujarat) Pvt. Ltd. (Astonfield) for developing a photovoltaic based power project in Gujarat. Soon after the commencement of the project, it was paused multiple times temporarily on account of heavy rain and turbulence. Hit by this, Astonfield incurred heavy losses and was forced into insolvency. Thereafter, Gujarat Urja issued notices for termination of the contract on failure of Astonfield to remedy the occurred default as a result of the admission of CIRP.

The NCLT allowed the application for injunction on the issued notices, which was allowed by the NCLAT as well. The matter went up in appeal to the Supreme Court wherein the primary issue of jurisdiction of the NCLT / NCLAT subsequent to contractual obligations and its regulation under the IBC was discussed.

Striking a balance between the rescue of the debtor on one hand and that of contractual freedom on the other, the Apex Court opined that the powers of the tribunal must be derived from the text of the legislation and words cannot be added for that purpose. In that context, section 60(5) of the IBC has vested enormous power in the NCLT / NCLAT in relation to the CIRP.

Relying on the powers under section 60(5) of IBC, the Apex Court held that the NCLT / NCLAT had jurisdiction to restrain the termination notices arising out of contract obligations. The point of caution marked is the fact that such a decision was arrived at relying on the centrality of the PPA agreement to the CIRP of the CD. The court clarified that such wide discretionary powers can only be granted in terms of matters which are intrinsically related to the CIRP and no other unrelated grounds shall qualify for such invocation. The Court also noted that it was not laying down a general principle on the contours of the exercise of residuary power by the NCLT under section 60(5) of the IBC. The Court further observed that the NCLT cannot exercise its jurisdiction over matters dehors the insolvency proceedings since such matters would fall outside the realm of IBC.

Distinguishing this case, the Supreme Court in *Tata Consultancy Services v. SK Wheels (P) Ltd. (Resolution Professional)*[5] (TCS case), reiterated that in the *Gujarat Urja* case, the NCLT was granted wide ranging powers solely because the insolvency itself constituted an event of default and there was no other default committed by the CD.[6] In the *TCS* case however, pursuant to the facilities agreement between Tata Consultancy Services Private Limited (TCS) and SK Wheels Pvt. Ltd. for conducting examinations in educational institutions, termination notices were issued by TCS on account of multiple breaches of the facilities agreement by the CD. Subsequent to the admission of the CIRP, the termination notices were stayed by the NCLT under section 14 of the IBC, to ensure that the debtor remains a 'going concern'.

It was clarified by the court that that since the termination of the facilities on ground was not connected with the CIRP, the precedent in *Gujarat Urja* case cannot be applied to the facts of the *TCS* case. Unless the termination of a contract is central to the process and would ultimately lead to the death of the CD, such termination should not be interfered with by the NCLT in any case.

In the *Gujarat Urja* case, the Supreme Court also relied on the judgement in *Embassy Property Developments (Private) Limited v. State of Karnataka*[7] (Embassy case). In this case, the CD held a mining lease which was granted by the state of Karnataka. Upon being admitted to insolvency, the Resolution Professional sought an extension from the government for the lease. The proposal for extension was rejected primarily on the ground of violations by the CD.

An application was filed before the NCLT seeking quashing of the government order and allowing extension of the lease, which application was allowed by the NCLT. An appeal was filed before the High Court wherein the matter was remanded back to the NCLT for fresh consideration.

The primary issue of contention was the jurisdiction of the High Court to interfere with the order of the NCLT in the matter. It was held that the contractual agreement was between the state and the CD, which is a matter of public interest governed by the relevant statute. Consequently, only a court of appropriate authority would have adequate jurisdiction to decide the matter. The NCLT, being a quasi-judicial body, which is a creation of statute, cannot be elevated to the status of a superior court vested with the power of judicial review. It is considered well settled that a quasi-judicial body cannot have jurisdiction over matters governed by public law.

In summary, current jurisprudence recognises the residuary powers of the NCLT to extend over disputes (a) arising pursuant to admission of insolvency proceedings against a CD; and/or (b) central to the insolvency resolution of a CD (for instance, where the outcome of the dispute could lead to the death of the CD). On the other hand, the NCLT is devoid of jurisdiction over matters which do not fulfil the above criteria or matters which relate to public policy, or such other matters which fall exclusively within the jurisdiction of special fora. This latter position, especially, would need to be evolved further considering the numerous special fora which have already been established in India for special matters (such as for mortgage suits, disputes under trust laws, arbitration matters, etc.), and overlap of such matters with pending corporate insolvency resolution of a CD.

FOREIGN JURISDICTIONS

USA

Bankruptcy courts are set up as a division of federal district courts and adjudicate on matters involving Title 11 of the US Code (Bankruptcy Code). Title 28, section 1334 of the US Code gives federal district courts jurisdiction over all cases arising under the Bankruptcy Code or in a bankruptcy case, as well as proceedings related to a case under Title 11. Generally, the jurisdiction of bankruptcy courts rests on whether a particular proceeding or case is a core proceeding under Title 28, section 157(b)(2) (non-exhaustive list), or a non-core but related proceeding or a completely non-core proceeding. A core proceeding would be one which is integral to the restructuring of the debtor-creditor relationship.[8]

By way of illustration, under Title 28, section 157(b) of the U.S. Code, Core proceedings include

> *(A) matters concerning the administration of the estate; (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11....; (C) counterclaims by the estate against persons filing claims against the estate; (D) orders in respect to obtaining cre*dit; (E) orders to turn over property of the estate; (F) proceedings to determine, avoid, or recover preferences; (G) motions to terminate, annul, or modify the automatic stay; (H) proceedings to determine, avoid, or recover fraudulent conveyances; (I) determinations as to the discharge-ability of particular debts; (J) objections to discharges; (K) determinations of the validity, extent, or priority of liens; (L) confirmations of plans; (M) orders approving the use or lease of property, including the use of cash collateral; (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and (P) recognition of foreign proceedings and other matters under chapter 15 of title 11...

Further, if the matter is a core proceeding, then the bankruptcy court can make a final judgment on the merits, subject to the review of the district court. However, if the bankruptcy court comes to the conclusion that a matter is not a core proceeding but is related to a bankruptcy case, the bankruptcy judge is allowed to make a final judgment on merits only if the parties to the dispute so consent. Otherwise, they are only allowed to submit their opinions on the case – any findings of fact or conclusions of law, to the district court. The district court can make any final orders or judgments in such non-core proceedings, after taking the bankruptcy court's findings and conclusions into account. Such related to proceedings under Title 11 are considered non-core, in that they '*do not invoke a substantive right created by bankruptcy but nonetheless fall within the jurisdiction of the bankruptcy court because they share a nexus with the bankruptcy case and will have some 'conceivable effect' on the administration of the debtor's estate'.* [9]

The judgment of the court in *Pacor, Inc. v. Higgins*[10] is widely cited and has given rise to the *Pacor* test. The court has observed:

> The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy. Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

In this context, the concept of adversary proceedings/bankruptcy litigation under rule 7001 of the Federal Rules of Bankruptcy Procedure may be further examined. An adversary proceeding can be initiated when a cause of action that is related to the bankruptcy but needs to be handled separately arises. Such proceedings are generally initiated by a debtor, creditor, or trustee in order to enforce some right vested in them, which could not be enforced by simply filing a motion under the main bankruptcy case.

Bankruptcy courts have held that adversary proceedings initiated as to quiet title of property, even by third parties[11] are maintainable before them through the related to stipulation under section 157(b)(3) and section 1334(b).[12] The court, in *Bushman Custom Farming, LLC v. Stillmunkes (In re Stillmunkes),*[13] concluded that it had related to jurisdiction over the claims against a debtor. The court found that the outcome of the adversary proceeding *'could change the value of Creditor's allowed claim, even though Debtor has not objected to it and it is small relative to the Debtor's overall liabilities'.*[14]

There is also the possibility for removal of cases from state forums to bankruptcy courts under Title 28, section 1452(a), which states that -

> A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

The procedure for such removal is given under rule 9027 of the Federal Rules of Bankruptcy Procedure. Section 1452(b) states that once a dispute is removed to the bankruptcy court, the court can choose to remand the dispute on some equitable ground. Such removal is often sought by parties who might feel that a particular state law claim or cause of action would be better suited to adjudication by a bankruptcy court which has jurisdiction over the matter.

However, it has also been interpreted by the Supreme Court that even in cases where a claim has the statutory designation of being core, the jurisdiction of bankruptcy courts may be ousted if they do not have the constitutional authority to hear such claims. This argument stems from Article III of the US Constitution which mandates that judicial power of the USA is vested with the Supreme Court and inferior courts (district courts). Despite bankruptcy courts being a division of federal district courts, they are established under Article I of the Constitution. In *Stern v. Marshall,*[15] the Supreme Court in deciding a counterclaim for tortious interference, had stated that the test to determine whether a claim/ issue is determinable by bankruptcy courts is '*whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process*.' The decision in Stern was stated to relate to the specific facts before it, however it has inevitably had wider implications.[16]

Section 1334(c)(2) also provides for mandatory abstention from hearing matters by the bankruptcy courts in certain scenarios. This has been interpreted in *Lindsey v. O'Brien (In re Dow Corning Corp.)*[17] – '*For mandatory abstention to apply, a proceeding must: (1) be based on a state law claim or cause of action; (2) lack a federal jurisdictional basis absent the bankruptcy; (3) be commenced in a state forum of appropriate jurisdiction; (4) be capable of timely adjudication; and (5) be a non-core proceeding*'.

In cases of permissive abstention under section 1334(c)(1), the court in *Williams v. Citifinancial Mortgage Co.* (*In re Williams),*[18] laid down a 12-factor test to determine whether the bankruptcy court should abstain from hearing a matter or not. The factors included – *'the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention; the extent to which state law issues predominate over bankruptcy issues; and the degree of relatedness or remoteness of the proceeding to the main bankruptcy case,'* among others.

In this regard, it appears that disputes that intrinsically relate to the determination of restructuring between a debtor and their creditors can be brought before the bankruptcy court in the form of adversary proceedings. However, the decision in Stern, with regard to the constitutionality of a bankruptcy court's jurisdiction, even over core bankruptcy proceedings has made the situation hazy. Regardless, setting aside the constitutionality challenge, the principles underpinning their statutory and judicial interpretations on the matter - core vs. non-core proceedings, related to jurisdiction, and the conceivable effects doctrine (i.e. Pacor test), do have commonalities with the Indian position.

In as much as section 60(5)(c) of the IBC confers jurisdiction on the NCLT to decide matters '*arising out of or in relation to insolvency resolution or liquidation proceedings*', obvious parallels can be drawn to the core vs. non-core dilemma and related to jurisdictional aspects of the US position. Further, the Indian Supreme Court in *Gujarat Urja* and *Vishal Ghisulal* spoke about the jurisdiction of the NCLT in matters which have a clear nexus with insolvency/liquidation proceedings.

Further, the enactment of a removal clause within the IBC in the nature of Title 28, section 1452 would also be prudent. Allowing parties in a related dispute pending before a civil court to make such decisions the subject matter of the insolvency court, in the interest of efficiency and quality of the insolvency or liquidation process, would go a long way in fulfilling the objectives of the IBC.

UK

The UK Insolvency / Liquidation regime with respect to companies is governed by the Insolvency Act, 1986 (UK Insolvency Act). Chapter VI of the UK Insolvency Act specifically deals with winding up of companies by the court. Section 117(1) of the UK Insolvency Act states that the High Court of England and Wales has jurisdiction to wind up any company registered in England and Wales.

Within the High Court, the Insolvency and Companies List of the Business and Property Courts division takes up matters relating to insolvency/liquidation. The Insolvency and Companies List is authorised to handle all insolvency matters appearing before the High Court. Insolvency Work includes petitions, applications and claims relating to insolvent corporations and individuals. Other than generally being governed by the Insolvency Act, matters relating to insolvency could involve many other areas of law covered by various pieces of legislation.[19]

In such cases where the dispute could be brought before multiple specialist fora, it is stated that '*the claimant must consider whether there are aspects requiring the expertise of a specialist judge and choose the list, sub-list or court in which the relevant specialist judges sit'.* [20] The most prudent way forward would be for a claimant to come to a decision on the overriding nature of the dispute and then issue proceedings in the appropriate court, even if part of the dispute would normally be better suited to being heard in another court/list.

Regardless, the relevant court shall have the power to rectify any error made in deciding jurisdiction if it so desires under Rule 3.10 of the Civil Procedure Rules, 1997. Further, Rule 30.2 speaks about transfers between various county court benches as well as district registries, Rule 30.5 speaks about transfers of disputes between the specialist lists of the High Court, and Rule 30.3(2) lays down certain criteria that need to be followed in deciding whether a case must be transferred, including the financial value of the claim and the amount in dispute; whether it would be more convenient or fair for hearings (including the trial) to be held in some other court etc.

In this context, the transfer of disputes not primarily based on insolvency matters to the Insolvency and Companies List is authorised at the discretion of the relevant judge. While the structures of the court systems in the UK and India strongly differ, the ability for disputes to be transferred to a forum where they may be more conveniently tried is a valid consideration for the Indian system to recognise. In this regard, the ability to remove/transfer disputes is a feature that is common across both the USA and the UK; however, the agents for such removal / transferal are different - being the parties themselves and the specialist judge respectively.

UNCITRAL

The UNCITRAL is the core legal body of the United Nations system in the field of international trade law.[21] UNCITRAL formulates modern, fair, and harmonised rules on commercial transactions. These include conventions, model laws and rules which are acceptable worldwide, legal and legislative guides, recommendations of great practical value, updated information on case law and enactments of uniform commercial law, technical assistance in law reform projects, and regional and national seminars on uniform commercial law.[22] One of the legislative guides by UNCITRAL is the Legislative Guide on Insolvency Law.

The UNCITRAL model law has discussed the jurisdiction of matters arising in the course of the insolvency proceedings. The competence for commencement and all later issues arising in the conduct of insolvency proceedings may lie with the same court of a State or different courts will have competence for different issues. To increase the transparency and ease of use of the insolvency law for the benefit of debtors, creditors and third parties (especially when they are from a foreign country), it should be made clear in the law which courts have jurisdiction over which matters. Although provisions specifying which courts have jurisdiction over insolvency proceedings may not always be included in the insolvency law, a reference to the provisions of the law other than the insolvency law that specifies court jurisdiction might usefully be included in the insolvency law.[23]

Firstly, it is recommended that the relevant insolvency laws should clearly indicate (or include a reference to the relevant law that establishes it) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings.[24]

The second recommendation by the UNCITRAL prescribes that the insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings, including:

(a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;

(b) Entrusting the administration or supervision of the debtor's business, which may include the power to use and dispose of assets in the ordinary course of business, to an insolvency representative or other person designated by the court;

(c) Entrusting the realisation of all or part of the assets of the debtor to an insolvency representative or other person designated by the court, in order to protect and preserve the value of assets of the debtor that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and

(d) Any other relief of the type applicable or available on commencement of proceedings.[25]

CONCLUSION

The provisions of the IBC, as further interpreted by Indian courts (including in the *Gujrat Urja* case, the *TCS* case and the *Embassy* case), have laid down elaborate groundwork regarding the residuary jurisdiction of insolvency courts with respect to questions of law or fact arising out of or in relation to the CD's insolvency resolution or liquidation under IBC. Nevertheless, the jurisprudence on this matter is at a nascent stage. For further evolution and interpretation, Indian legislature and Indian courts may rely on principles laid down and applied under foreign insolvency laws, including under the bankruptcy regime in the US being (a) test of core vs. non-core proceedings, (b) related to jurisdiction, and (c) conceivable effects doctrine (i.e., Pacor test), to be applied on a case-to-case basis.

1 Section 408, Companies Act, 2013.
2 Also relied upon by the courts in *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta, (2020) 8 SCC 531.*
3 (2021) 7 SCC 209.
4 *Ibid.*
5 (2022) 2 SCC 583.
6 *Ibid.*
7 (2020) 13 SCC 308.
8 Henninger S. (2020), "Bankruptcy Courts and the Constitution", American Bar Association.
9 *Williams v. Citifinancial Mortgage Co. (In re Williams),* 256 B.R. 885 (2001).743 F.2d 984 (1984).
10 *743 F.2d 894 (1984).*
11 *Lindsey v. Duckworth Dev. II (In re Lindsey)*, 2021 WL 1140661 (11th Cir. 2021).
12 Kennedy C. (2021), "Bankruptcy Court May Exercise "Related to" Jurisdiction Over Quiet Title Action", *Riker Danzig*, 13 July.
13 Bankr. N.D. Iowa, 19-01011 (2020).
14 Hardy R. (2020), "*Court May Exercise "Related To" Jurisdiction Over Adversary Complaint By A Creditor Against a Third Party"*, Spencer Fane LLP.
15 564 U.S. 462 (2011).
16 Freeman J. (2020), "Bankruptcy Court Jurisdiction", Freeman Law.
17 86 F.3d 482, 497 (6th Cir. 1996).
18 Supra Note 7
19 Chancery Guide (2022), HM Courts & Tribunals Service, 111.
20 UK Judiciary (2017), "Advisory Note and Draft Practice Direction for the Business and Property Courts", Courts and Tribunals Judiciary.
21 UNCITRAL
22 *Ibid.*
23 UNCITRAL (2005), "A Legislative Guide on Insolvency Law", United Nations.
24 *Ibid.*
25 *Ibid.*

5

STREAMLINING CIRP:
A MULTI-FACETED CHALLENGE

— *Eshan Jaipuriar and Rishika Raj*

Executive Summary

The success of any corporate insolvency resolution process (CIRP) is embedded in its speedy resolution, a consolidated framework is therefore envisaged under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and to meet this end. The paper strives to underline the fact that due to the absence of interim-moratorium individual creditors engage into opportunistic practices of independently appropriating their assets and thereby defeating the *in rem* process envisaged under the Code. The paper further examines how the concessions and waivers which form an integral part of the plan need to be streamlined and standardised in order to ensure that precious judicial time is not spent on such adjudication. The paper finally examines how the Hon'ble Supreme Court's order in *Ebix* wades away from the concept of economic legislation and in a manner curbs the autonomy of the resolution applicants. The paper brings to light the fact that the plan approval application on an average takes more than 200 days and therefore the dynamics of the plan are liable to change in such situations therefore it is incumbent upon the Adjudicating Authority (AA) to allow some sort of modification in the plan in order to ensure that the successful resolution applicant is not caught in an unworkable plan, which will eventually lead to liquidation of the corporate debtor (CD) and may also push the successful resolution applicant into insolvency.

Keywords: Interim Moratorium, Delayed Admissions, Concession and Waivers, Economic Legislation, Resolution Plan

INTRODUCTION

'This bond doth give thee here no jot of blood; The words expressly are a pound of flesh.'

The Merchant of Venice Act 4, scene 1, 304–307

This formidable argument was put forth by Portia in the Merchant of Venice in order to rescue Antonia from the moneylender Shylock. This succinctly portrays that how insolvency was perceived in the Medieval ages, one had to part with a pound of flesh as Antonio was bound by the bond where such promise was made to a Jewish moneylender Shylock to whom Antonio owed money.

However, what the quote also reflects is the sanctity of the assets that need to be retained and no extra ounce could be misappropriated or let go. This under the Indian insolvency framework is taken care of, by the provision of moratorium under section 14 of the IBC. The essence of imposition of a moratorium is to preserve and protect the assets of the CD to ensure a comprehensive resolution which would effectuate better value.

The Banking Law Reform Committee (BLRC) in its interim report[1] has aptly expounded on this concept in the following manner:

> The inefficiency of the corporate rescue and winding up/liquidation regime in India has led to a situation where most creditors prefer to initiate separate recovery proceedings (often involving the same assets) irrespective of the viability of the company. This leads to conflicts, disorderly distribution, delays and depletion in value of the company, which could have otherwise been rescued.

The underlying premise of the observations made by the BLRC is the fact that independent and separate action by the creditors need not be ideal for successful resolution of the CD and therefore, there is a need to abide by an *in rem* process which ensure that assets of the CD are pooled in and collectively disposed in order to ensure better reorganisation.

This research paper aims to examine as to how the Code provides that an application for initiation of a CIRP must be admitted within 14 days of the receipt of the application, this timeline has been held to be directory[2]. On a further review of cases, it appears that in practice, AAs are taking much longer than 14 days to admit applications under the Code. On the strength of data provided by the Insolvency and Bankruptcy Board of India (IBBI), a total of 2739 CDs were analysed (up to December 2021) and it was observed that the average time taken by the AA to admit a CD into CIRP is 280.375 days i.e., more than nine months as against the stipulated timeline of 14 days. This leaves ample scope for misappropriation of assets by the promoters and incentivises creditors of the CD to race to enforce their security interest in the period leading up to the commencement of the CIRP, which may undermine a collective and value maximising insolvency resolution[3]. Based on the above we conducted a survey and according to the survey results, 70% of stakeholders believe that it takes more than 90 days for initiating CIRP[4]. Furthermore, a graphical analysis of the IBBI data demonstrates that more than 98% of the cases take more than 14 days to get admitted in CIRP, this is indicated in in Fig. 1.

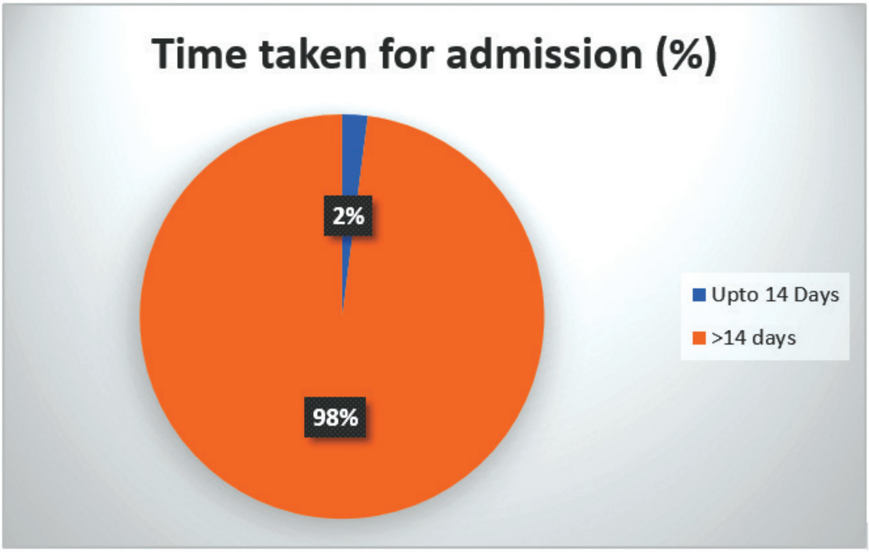


Fig. 1: *Data up to December 2021 showcasing time taken for admission of application under CIRP*

We further conducted a survey of stakeholders wherein an overwhelming majority of the stakeholders opined that the time taken between filing of application till the admission order is passed (hereinafter referred as the '*interregnum*') the promoters and the creditor engage in opportunistic behaviour causing a run on the assets, while the promoters rush to misappropriate the assets the secured creditors engage in a race to appropriate their assets in order seek early recovery, undermining the collective process to be undertaken during CIRP under the Code[5]. Such behaviour is demonstrated in the survey response in Fig. 2, below:

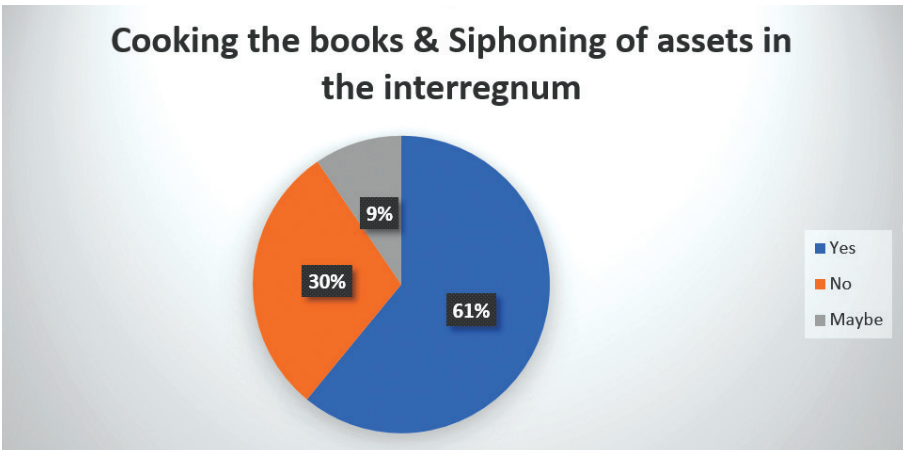


Fig. 2. *The above pie chart clearly depicts that >60% of the respondents are of the view that such opportunistic behaviour is prevalent during the interregnum.*

In order to abate such opportunistic behaviour this paper proposes the introduction of interim-moratorium by way of inserting section 13A in the Code, in lines with the recommendations made by sub-committee of the Insolvency Law Committee (ILC) for notification of Financial Service Providers[6], which made the following observations:

> The key assets of most FSPs include properties which can be easily transferred. For instance, for NBFCs in the business of lending, their primary assets are the loans and their associated receivables. In the absence of an interim-moratorium, such assets can be easily transferred to third parties before a case is admitted. This can completely undermine the process (as without such assets, it may not be possible to resolve such FSPs at all).

Similar observations have been recorded by the ILC[7] in the following manner:

> In this background, the Committee recommended that requisite amendments should be made to introduce a provision allowing for an 'interim-moratorium' to be put in place after an application for initiation of CIRP has been filed.

In order to further strengthen our proposal, the paper conducted a survey of the stakeholder, on the need to introduce interim-moratorium, in order to safeguard the assets of the CD, and an overwhelming majority of respondents believed that such moratorium is the need of the hour. The results are demonstrated in Fig. 3

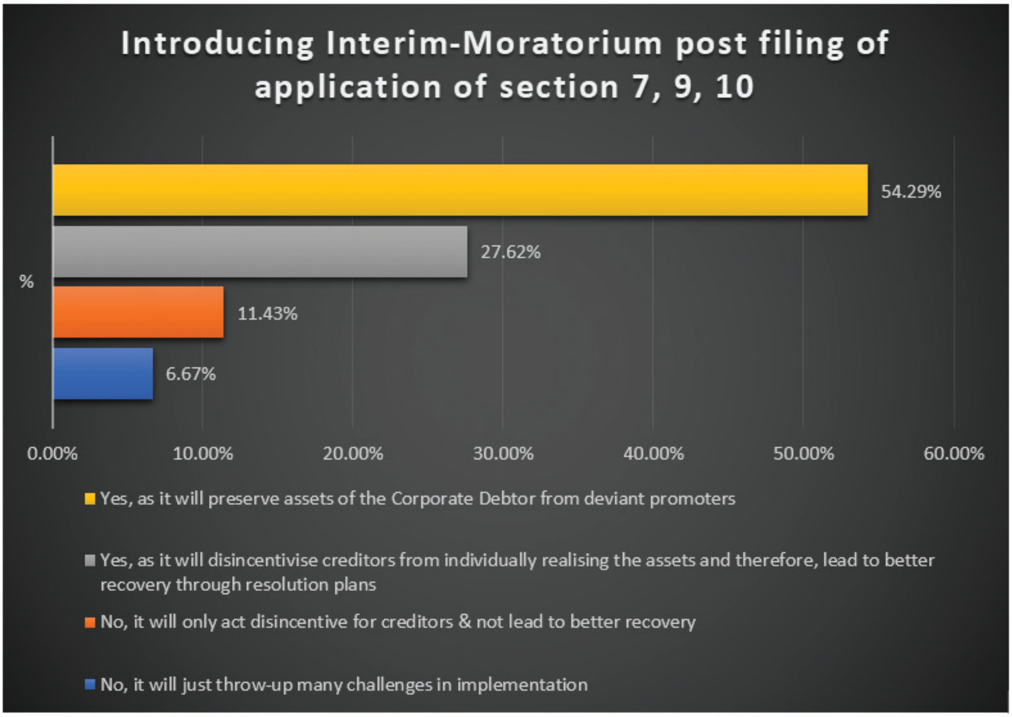


Fig. 3. *The above bar graph depicts that an overwhelming majority of respondents believe that a provision for interim-moratorium should be introduced*

Thus, the paper bears in mind the situations where the application is not admitted within 14 days, there is a concern that the management of the CD, whose powers will vest with the interim resolution professional (IRP), and thereafter the resolution professional (RP) once the CIRP commences, may have an incentive to siphon off the assets of the CD in the period leading to the commencement of the CIRP. Towards this end the paper proposes the introduction of 'interim-moratorium' by way of inserting section 13A to the Code, which should commence on and from the date of filing of the application under section 7, 9 or 10 and should continue till its admission or rejection.

The paper further delves into the issue of 'concessions & waivers' sought by the resolution applicants with the intent of getting the Resolution Plan (plan) approved along with such exemptions, some of which are even made a 'condition-precedent' for implementation of the plan. Such exemptions are typically in the nature of waiver of any Income-tax and Minimum Alternate Tax (MAT) liabilities, exemption from paying stamp duty or making regulatory filings with Registrar of Companies etc. Adjudication of such exemptions consumes a lot of precious judicial time of the Hon'ble AA and lengthens the CIRP. In order to contain such spillover of judicial time, the paper proposes formulating a 'Negative list of Concessions and Waivers' which could be used as a benchmark by prospective RAs to draft concise plans and not populate the plan with such frivolous request for exemptions which are anyway liable to be rejected by the Hon'ble AA (*ref: Bank of Baroda & Anr. v. Kilburn Chemical Ltd.*[8]).

Lastly, the paper argues how the recent order of the Hon'ble Supreme Court in *Ebix Singapore Pvt. Ltd.*[9] (*Ebix*), throws up novel hurdles for RAs by binding them to a plan which might have become commercially unviable and unfit for implementation. The paper proposes to take a deep dive into the issue and bring out the RAs' perspective on how a fairly flexible insolvency regime allows adequate elbowroom for experimentation and successful implementation of the plan, as opposed to an ecosystem which by way of a judicial diktat binds the RA, even in an unworkable plan. This essentially takes away the space for experimentation and eventually discourages successful resolution of the CD, which is the cornerstone of the Code. It is therefore, pertinent to recall the words of Hon'ble Justice Rohinton F. Nariman in *Swiss Ribbons*, *'To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation.'*

The Economic Survey[10] succinctly defines the transition of Indian economy as *'socialism with restricted entry to marketism without exit'*, it is, *inter alia*, this challenge of exit that the Code strives to address. The Code, over a short span of five years has witnessed remarkable paradigm shift in credit culture and has ushered in a new era of distress resolution. As a fledgling legislation, the Code finds itself in midst of issues which require further streamlining, the paper therefore strives to identify and address a few of these issues.

The World Bank Report[11] in 2001 titled 'Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws' identified the following issue as follows:

> If filing for bankruptcy means that the firm shuts down immediately and managers lose their jobs, then managers have an incentive to delay bankruptcy as long as possible and use the extra time to gamble with or steal the firm's assets.

The aforementioned issue effectively captured in the survey response, wherein the following question was asked form a group of 105 respondents, the question reads as follows:

Q. Post filing of application of section 7/9/10 under the IBC, do promoters try to misuse the time at hand to cook the books & siphon of the assets. (if yes, please comment)

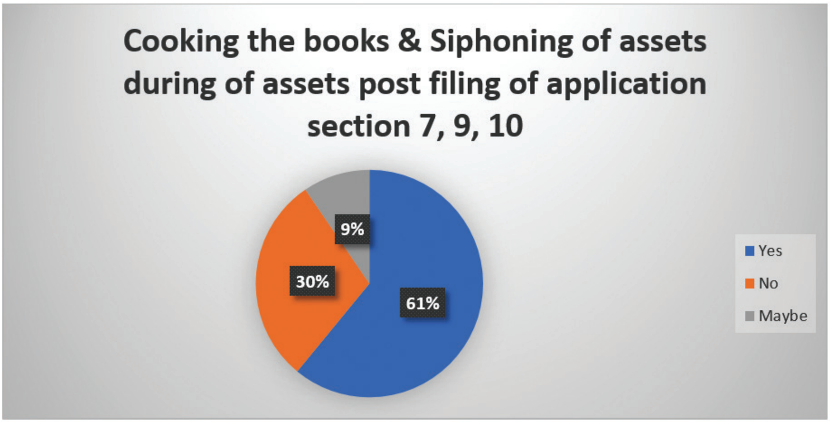


Fig. 4. *The above pie chart clearly depicts that >60% of the respondents are of the view that such opportunistic behaviour is prevalent during the interregnum.*

The paper therefore argues for the introduction of interim-moratorium in order to abate such opportunistic behaviour by both creditors and promoters, would ensure better resolution.

A sound and efficient insolvency regime is important for better investment, funding, economic growth, and cost of credit in the market. Insolvency regime has a direct bearing on allocation of resources in the economy. Hence for overall economic growth and development, a robust insolvency ecosystem is extremely critical.

The paper also brings forth the issue of concessions and waivers wherein the paper undertook a survey on the most commonly sought reliefs and concession asked in plan, a majority of the responses indicated that blanket approval/ deemed approvals are most commonly sought. Further the paper examined as to whether these concessions & waiver act as hindrance in plan approval. The responses are depicted in Fig 5. below:

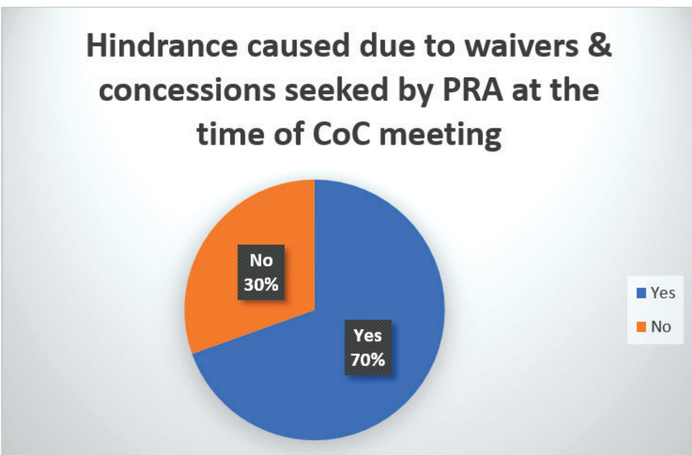


Fig 5. *The above pie-chart depicts that majority of the respondents are of the view that seeking of waivers and concessions (especially in the nature of condition precedents) act as a hinderance to the plan approval application.*

The paper therefore attempts to analyse such reliefs and proposes an indicative list of concessions and waivers not to be sought in the plan in order to further streamline the process.

The paper finally examines the Hon'ble Supreme Court's Order in *Ebix* and strives to constructively criticise the order on the premise that adequate elbow room needs to be given to the resolution applicant by way of modification especially when the plan approval application takes longer than a period of six months to get approved. The resolution applicant is generally anguished by such long drawn process which leads to both value depletion and unfavourable change of dynamics of the plan. The paper conducted a survey to gauge the view of the stakeholders, the same is depicted in Fig. 6 below:

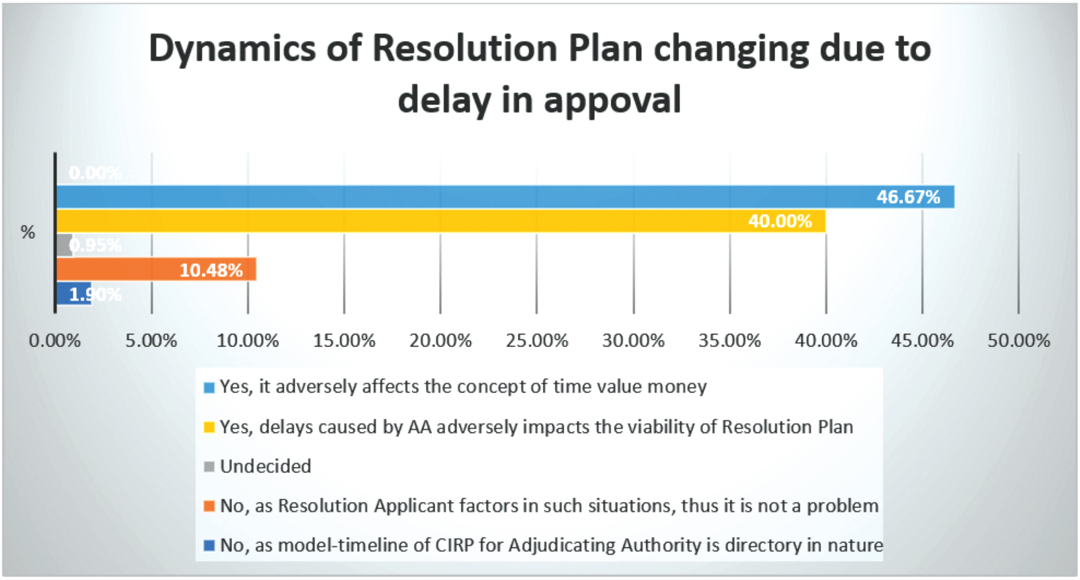


Fig. 6. *Out of the sample survey of 105 respondents, majority stakeholders are of the view that delay in approval of the Resolution from Hon'ble AA adversely impacts the plan in terms of commercial dynamics, feasibility and viability.*

Based on the data received from IBBI it was analysed that it takes more than 200 + days (7 months) for approval of a plan, this has been further elaborated in research findings. The paper therefore strives to offer the resolution applicant some breathing space especially in cases where the plan approval application is extending beyond a reasonable threshold.

STATEMENT OF PROBLEM

The Code envisages a consolidated *in rem* process that is a collective mechanism which incentivised all stakeholders to take part in the process, however this collective framework is undermined when there is a run on the CD's assets during the period prior to commencement, this issue plagues the current CIRP regime and results in stripping the CD of its prime assets. In light of this, the paper examines the issue of opportunistic behaviour by promoters and creditors and explores the introduction of interim-moratorium during CIRP.

Concessions & waiver form an indispensable part of any plan, some of these waivers are also sought as 'condition precedents' thereby making the plan condition/contingent on occurrence of certain events, the paper examines these issues proposes a negative list of concessions and waivers which would act as an indicative list of reliefs not to be sought in a plan.

The Paper finally strives to demonstrate how the IBC is an economic legislation which requires certain elbow room to carry out experimentations based on the constantly evolving market dynamics furthermore, reference is being drawn from Hon'ble Supreme Court's order in *Ebix*[12], whereby the paper argues how party autonomy needs to be respects in order allow better investment and successful resolution.

RESEARCH OBJECTIVES

In the above background, this research aims to understand how the three issues enlisted above be addressed in a manner that the Code achieves its maximum potential and is brought closer to its preamble. Further the paper aims to suitably amend the Code in order to introduce interim-moratorium provisions under CIRP to ensure that there is no run on the assets of the CD and create a tailor-made list of concessions and waiver which will act as an indicative list for resolution applicants, so that they do not engage in seeking frivolous concessions and reliefs. Lastly, the paper strives to demonstrate how a flexible and experimentational regime promotes better realisability of debt and resolution of the CD.

RESEARCH QUESTIONS

With the above objectives, this research aims to look into the following questions:

(a) Whether an 'interim-moratorium' needs to be introduced for CIRP once an application under section 7, 9 or 10 is filed, in order to preserve the assets of the CD from erring creditors, who immediately move to appropriate the assets under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), with the sole intention to circumvent the CIRP.

(b) Whether a standardised 'Negative list of concession and waivers' not to be sought by way of a plan, be formulated to save precious judicial time of the AA.

(c) Whether the judgment of the Hon'ble Supreme Court in *Ebix*, sets the clock backwards on the concept of economic legislation, and essentially imposes a legal remedy to a rather economic problem.

LITERATURE REFERENCE & RESEARCH METHODOLOGY

The Code was introduced with the objective for timely resolution of the piled-up non-performing assets (NPAs). It has brought a paradigm shift in the insolvency ecosystem in India by removing the earlier outdated institutional structure.

The objective of the research paper is to bridge the gap between the issues mentioned in the research paper. The approach in the study has been two pronged: firstly, collection of data from IBBI of time taken by AA for passing admission order and time taken by AA for approval of the plan. Secondly, a survey was conducted for various stakeholders in the insolvency ecosystem such as Insolvency Professionals, Insolvency Professional Entities, creditors, advocates & resolution applicants. This was taken in order to understand perception and experiences of the various stakeholders. A total of 105 respondents took part in the survey. The sample size of 105 respondents helped us understand the experiences of various stakeholders in the insolvency ecosystem (Annexure 1 of the paper includes questionnaire with answers).

We have undertaken analytical research in reference to the issue by finding and collating the list of negative waivers & concessions granted by National Company Law Tribunal (NCLT), Kolkata (Annexure 2 of the paper list of negative waivers & concessions).

We have also undertaken analytical research of several orders of the Hon'ble Supreme Court, National Company Law Tribunal (NCLAT) and NCLT, and carry out critical analysis of the judgments, with the assistance of legal databases such as SCC Online, Lexis Nexis, Manupatra etc.

We have put to use investigator's triangulation by referring to IBBI / RBI Reports, legal authorities, and precedents in order to put forth the complete picture of the issue at hand. Further the part of quantitative research is based on Economic Survey Vol. I & Vol. II 2020-21, RBI Report on Trend and Progress of Banking in India 2020-21, IBBI quarterly newsletter, October-December, 2021 and Annual Publications etc.

LIMITATION OF THE STUDY

At the onset, we would like to point out that though an honest attempt has been made to answer the research questions at hand through the survey and data from various sources, nevertheless it suffers from certain limitations. Such limitations are that data is up to December 31, 2021 and the sample size could be expanded up to 105 respondents only.

Another limitation is that for the research purpose the scope of data in second issue was orders of various jurisdictions of NCLT, however, major emphasis was laid on orders of NCLT, Kolkata.

RESEARCH FINDINGS

Issue 1

Whether an 'interim-moratorium' needs to be introduced for CIRP once an application under section 7, 9 or 10 is filed, in order to preserve the assets of the CD from erring creditors, who immediately move to appropriate the assets under the SARFAESI Act with the sole intention to circumvent the CIRP?

The UNCITRAL Legislative Guide on Insolvency Law[13] (Legislative Guide) in its introductory remark on protection and preservation of the insolvency estate has stated as follows:

> Essential objectives of an effective insolvency law are protecting the value of the insolvency estate against diminution by the actions of the various parties to insolvency proceedings and facilitating administration of those proceedings in a fair and orderly manner.

The statement accentuates the need for promoting a consolidated framework where individual creditors are incentivised to opt for opting into to CIRP and effectuating better resolution of the CD. The Legislative Guide very aptly brings to light the fear of promoters and individual creditors trying to appropriate the assets by initiating separate actions and or indulging into avoidance transactions, this has been recorded in the statement, *'The parties from whom the estate needs the greatest protection are the debtor and its creditors.'*

The same could also be seen in the curious case of *Mohan Pillai v. Virgo Marine Shipyards & Ors.*,[14] wherein the AA was faced with the question as to sale of the prime asset of the CD which was a Hopper Barge in this case was appropriated by the secured creditor, the CD has sought for reversal of sale. The matter went up to the NCLAT, wherein the following interim order was passed, and it was held, '*Till then the 3rd respondent is directed to maintain status quo in respect of MV. VM Hopper Barge H-107 until further orders. Respondent no.3 shall not move the Vessel beyond the territorial jurisdiction of this tribunal'.*

This underlines the fact that how the creditors engage in opportunistic behaviour by selling prime assets of the CD before the application has been admitted, this in turn throws up situations where either the CD would be pushed into liquidation, or the promoters would be pushed into personal insolvency for the remaining amount which could not be recovered.

Based on the above the paper undertook a survey of relevant stakeholders seeking their response on the following questions:

Q. What do you believe would be the outcome of appropriating assets before the initiation of CIRP?

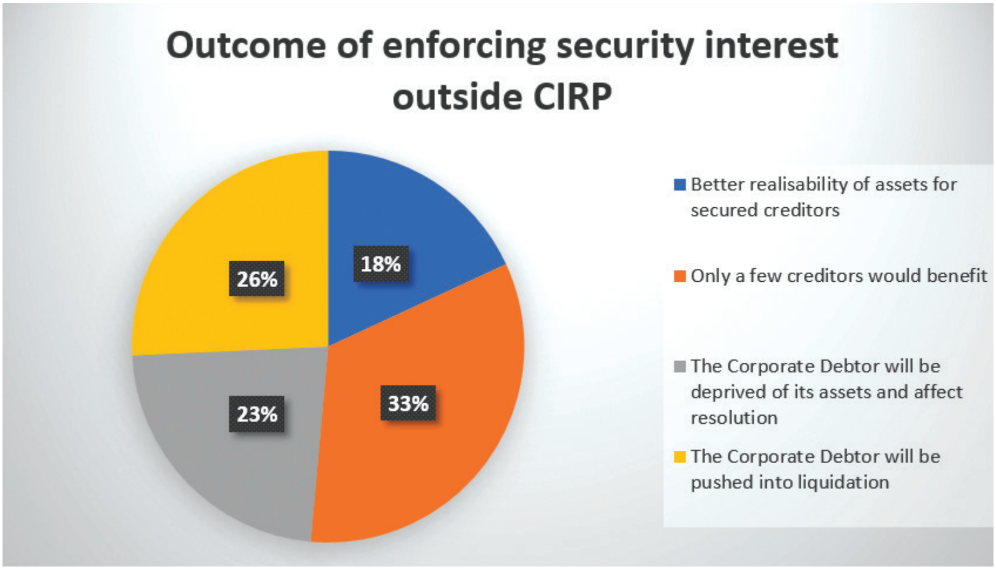


Fig. 7. *The graph depicts that a majority of the respondents believe that only a few creditors would benefit from such appropriation, which would further defeat the purpose of the Code and eventually end up getting liquidated.*

We further conducted a survey of stakeholders wherein an overwhelming majority of the stakeholders opined that the time taken between filing of application till the admission order is passed (hereinafter referred as the '*interregnum*') the promoters and the creditor engage in opportunistic behaviour causing a sun on the assets, while the promoters rush to misappropriate the assets the secured creditors engage in a race to appropriate their assets in order to seek early recovery, undermining the collective process to be undertaken during CIRP under the Code[15]. Such behaviour already been demonstrated in the survey response in Fig. 4, above.

UNCITRAL's take on interim-moratorium

The Legislative Guide argues that in order to address the period between application and commencement, some insolvency laws permit provisional measures to be ordered. While other provisions of insolvency law also may be relevant to protecting the insolvency estate before commencement, such as reclamation of assets, these generally will apply only after the event.

The need to have an interim-moratorium has been recorded in the Legislative Guide in the following manner:

> In some insolvency laws that do not provide for the proceedings to commence automatically when an application is made, the application of the stay on commencement is complemented by provisional measures that may be ordered between application and commencement to protect both the assets of the debtor that potentially will constitute the insolvency estate and the collective interests of creditors.

With regard to creditors, one of the fundamental principles of insolvency law is that insolvency proceedings are collective proceedings, which require the interests of all creditors to be protected against individual action by one of them. Many insolvency laws include a mechanism to protect the value of the insolvency estate that not only prevents creditors from commencing actions to enforce their rights through legal remedies during some or all of the period of the liquidation or reorganisation proceedings, but also suspends actions already under way against the debtor.

UK Bankruptcy law on interim-moratorium

Internationally too, jurisdictions such as the UK and the US have provisions for the application of a moratorium from the filing of the application itself.

The Insolvency Act 1986 (IA 1986) provides for an interim-moratorium applicable during the period between the filing of an application to appoint an Administrator or giving of notice of intention to appoint an Administrator and the actual appointment of such Administrator. Further, the IA 1986 provides for an automatic moratorium on insolvency proceedings. The moratorium on insolvency proceedings is wide in nature. Furthermore, there is an automatic moratorium on enforcement of security over the company's property.

US Bankruptcy law on interim-moratorium

The importance of such moratorium could also be seen from the cross-border situation which arose in the case of *In re: SEL Manufacturing Co. Ltd.,*[16] where in the Indian proceedings were recognised as 'main proceedings' and an automatic stay/moratorium was imposed pursuant to the US Bankruptcy Court for the District of Delaware order.

> All relief authorized by 11 U.S.C. § 1520 shall apply throughout the duration of this proceeding or until otherwise ordered by this Court, including, without limitation, the automatic stay authorized by 11 U.S.C. § 362.

Further, under Chapter 11, section 362 of the US Bankruptcy Code provides for an automatic moratorium on the enforcement of claims against the company and its property upon the filing of a petition. The moratorium covers judicial and administrative proceedings, enforcement of judgments against the company or its estate. However, secured creditors can approach the court to lift the stay under certain circumstances. The moratorium may be lifted for appropriate cause, including if, in the opinion of the court, the debtor company has not adequately protected the property interests of the creditor during the period of the moratorium.

Recommendations of the ILC

ILC in its recommendations for interim-moratorium has recommended that automatic application of interim-moratorium might not be ideal and therefore the AA be bestowed with the responsibility to grant the same. The ILC in this regard makes the following observations:

> The Committee felt that allowing the Adjudicating Authority to grant an interim-moratorium would give it an opportunity to assess the urgency of requiring such a moratorium, evaluate the necessity of such a moratorium in those cases where it is not established that the corporate debtor meets the commencement standard, and balance the harm such a moratorium would cause to the interests of the relevant stakeholders.

Therefore, the ILC agreed that the AAs should be empowered to pass an order declaring an interim-moratorium.

Dissenting with ILC

The paper begs to differ from the recommendations of the ILC as entrusting the AA with the responsibility of adjudicating on a case-to-case basis, would only add to the delay during the admission stage, furthermore such action would add an extra layer of litigation which might keep the AA embroiled in peripheral issues and would take away from the issue of admission of the CD into CIRP.

The paper therefore proposes, an automatic interim-moratorium which shall come into force from the date of filing of the application and shall cease to exist on the admission/rejection of the application. It is pertinent to note what observation, the BLRC interim report[17] has made in this regard, *'In order to prevent a precipitous break-up of a viable company before the NCLT decides on an application for a moratorium, there should be an automatic interim-moratorium in place till such determination...'.*

Therefore, an automatic interim-moratorium would be introduced by way of inserting section 13A to the Code, however the moratorium may be lifted for appropriate cause, including if, in the opinion of the court, the debtor company has not 'adequately protected' the property interests of the creditor during the period of the moratorium. It is pertinent to note that NCLT in *NUI Pulp*[18] has passed such an order exercising its inherent powers under the NCLT Rules.

Debtor-in-possession, with IRP/RP acting in supervisory role:

The paper proposes a debtor-in-possession model during the interregnum; however, the paper recommends that the IRP should have a supervisory role during this period to ensure that the assets of the CD are not misappropriated. This is a novel addition to the Code to ensure minimisation of avoidance transactions and also better enforcement of interim-moratorium. Further, such provisions address opportunistic, value-destroying behavior usually faced by debtors in the zone of insolvency (commonly referred to as the '*twilight zone*'), ensuring that creditors as a whole are treated equitably by allowing payments made or property transferred under certain transactions to be returned to the CD or their effect reversed.

The paper further proposes that the fees to the IRP be made the part of Insolvency Resolution Process Cost under section 5(13) of the Code. In case, where the CIRP is not admitted, the fees shall be borne by the applicant itself.

Race for appropriation of assets of the CD

In the absence of a collective procedure in the form of a corporate insolvency regime, the creditors may have incentives to run on the company's assets in the event of insolvency. Consequently, each creditor may want to initiate separate recovery proceedings for the same assets, leading to conflicts, disorderly distribution, delays and depletion in value of the company. According to a commonly held view, the main purpose of corporate insolvency law is to support the collective efforts of the creditors by providing a mandatory and collective procedure where the assets are distributed among the stakeholders in an orderly manner.

Recommendations

The paper therefore recommends the following amendment by insertion of 'section 13A: Interim-moratorium' to the Code, wherein an interim-moratorium would be introduced. Such moratorium would operate in a debtor-in-possession model and the IRP would only act in a supervisory role.

The draft proposed amendment is as follows:

13A Interim-moratorium. - Save as provided in section 14, *when an application is filed under section 7, section 9 or section 10-*

(a) an interim-moratorium shall commence on and from the date of filing of the application and shall cease to have effect on the date of admission or rejection of such application; and

(b) during the interim-moratorium period –

(i) the creditors of the debtor shall not initiate any legal action or proceedings in respect of any debt.

(ii) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

Explanation. *- For the purposes of this clause, "interim-moratorium" shall have the effect of the provisions of sub-sections (2) and (3) of section 14.*

Issue 2

Whether a standardised 'Negative list of concession and waivers' not to be sought by way of a plan, be formulated to save precious judicial time of the AA?

Concessions & waivers form an essential part of any plan and it is often observed that adjudication on such waivers occupy a lot of judicial time. Certain reliefs/waivers are also in the nature of 'condition-precedent' for implementation of the plan, such reliefs act as impediment to the plan approval application and are also not in consonance with the spirit of regulation 36A, of IBBI (Resolution Process for Corporate Persons) Regulations.

The AA was faced with a similar issue in *Punjab National Bank v. Saptarishi Hotels Pvt. Ltd.*,[19] wherein the applicant sought renewal of lease by another 33 years, and the committee of creditors (CoC) was informed that the clause enabling renewal of lease by another term is under consideration by the Government of Telangana, based on this premise the applicant sought constant extensions during CIRP. The AA therefore observed as follows:

> That apart, when not only the 'insertion' of the necessary provision for renewal of lease in the existing lease document, but also the fixation of the quantum of the period of the purported renewal, apart from being in the exclusive territory of the Government of Telangana, are certainly uncertain in as much as, the Government may or may not agree for the said condition. Moreover, as no time line is provided for taking a decision by the Government on the subject issue, we are unable find any rationale behind seeking further extension of time for completion of CIRP.

Adjudication of such exemptions consumes a lot of precious judicial time of the Hon'ble AA and lengthens the CIRP. In order to contain such spillover of judicial time, the paper proposes formulating a 'Negative list of Concessions and Waivers' which could be used as a benchmark by prospective resolution applicants to draft concise plans and not populate the plan with such frivolous request for exemptions which are anyway liable to be rejected by the Hon'ble AA.

In orders passed by AA allowing approval of plan during CIRP following prayers as part of reliefs/ concessions/relaxations were allowed as part of the order, based on this we conducted a survey to gauge the most commonly sought reliefs in a plan.

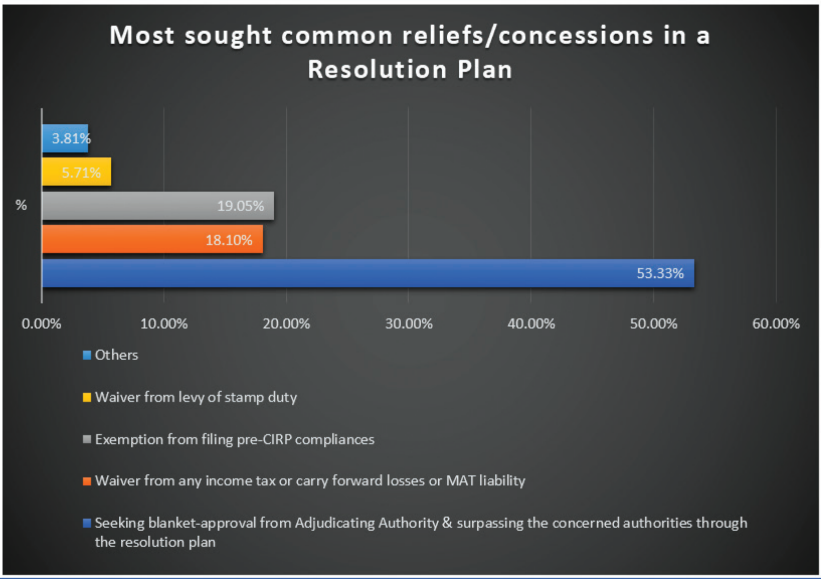


Fig. 8. *The above graph depicts that majority of the stakeholders believe that seeking blanket approvals/ deemed approvals are most commonly sought reliefs.*

Others (includes comments received)
None of the above
All of the above, but it depends on AA. Nowadays AA are also passing orders where consent of respective departments needs to be taken
All creditors will give approval for revival of company or winding of company
All the above depending upon case to case

Negative list of concessions and waivers

Following is an indicative list of concessions and waivers, which are not granted by the AA, it is recommended that the prospective resolution applicants must bear in mind such list so as to draft a more effective plan and not take up judicial time in determination of such waivers by the AA.

Sl. No.	Relief and/or Concessions Sought	Comments
1.	Waiver from the levy of stamp duty and fees by the stamp authorities, applicable in relation to the implementation of the plan.	Such reliefs are generally not granted, so they are best avoided in the plan
2.	Seeking exemption from all taxes, levies, fees, transfer charges, transfer premiums, and surcharges that arise from or relate to implementation of the plan, since payment of these amounts may make the plan unviable.	No general reliefs can be granted in the manner sought for. It is for the appropriate tax authorities to consider the same in accordance with the relevant law.
3.	Direction to authorities for providing key approvals like consent to establish, consent to operate, water approval, railways approval, etc.	Requisite applications or representations should be made before the authorities concerned.
Reliefs in the nature of deemed approvals to be avoided		
4.	Seeking reliefs in the nature of approval of the plan shall be deemed approval for waiver from filing of statutory returns (including but not limited to any filings for registrar of Companies, Direct & Indirect tax authorities, plant related annual filings, etc).	Such deemed approvals are generally not granted by the NCLT
5.	Direction seeking tax benefits and exemptions to continue to be applicable to the CD from effective date including benefits under section 79(2)(c) of the Income Tax Act, 1961 as applicable in the event the CD does not remain listed in future.	No general reliefs can be granted in the manner sought for. It is for the appropriate taxing authorities to consider the same in accordance with the relevant law.

Sl. No.	Relief and/or Concessions Sought	Comments
6.	Any requirements to obtain reliefs / exemptions / waivers from any Tax Authorities including in terms of sections 170 and 281 of the Income tax Act is deemed to have granted upon approval of this plan on the NCLT approval date.	No general reliefs can be granted in the manner sought for. It is for the appropriate taxing authorities to consider the same in accordance with the relevant law.
7.	Seeking directions from AA that actions taken against the personal guarantees extended by the promoters and guarantor be quashed by way of the NCLT order.	NCLT does not grant such reliefs, furthermore it is beyond the remit of the plan.
8.	All Governmental Authorities (including but not limited to Income Tax Authority, Service tax Department, VAT Department and GST Department) to waive the non-compliances of the CD or further claims of the Governmental Authorities on the CD arising out of or in relation to the past claims, and/or actions, deed/s or thing/s prior to the insolvency commencement date.	Requisite applications or representations should be made before the authorities concerned.
9.	The approval of the plan shall act as necessary directions to Central Board of Direct Taxes: For exemption from the provisions of Income Tax Act, 1961, for Claim set-off of the entire Minimum Alternate Tax (MAT) credit as available to the CD, against the normal income tax as would be payable by the CD post the Approval Date, i.e., no normal taxation should be applicable until the MAT credit is adjusted/utilised in full. Waiver of the penalty, interest levied under the Income Tax Act, 1961, and tax deducted at source, TDS returns etc.	Mostly in all cases NCLT states that this is up to the authorities concerned to consider the matter.

Based on the above, our paper demonstrates how majority of the stakeholders believe that a standardised list of concessions and waivers would yield better resolution. The same is depicted in Fig. 9 below:

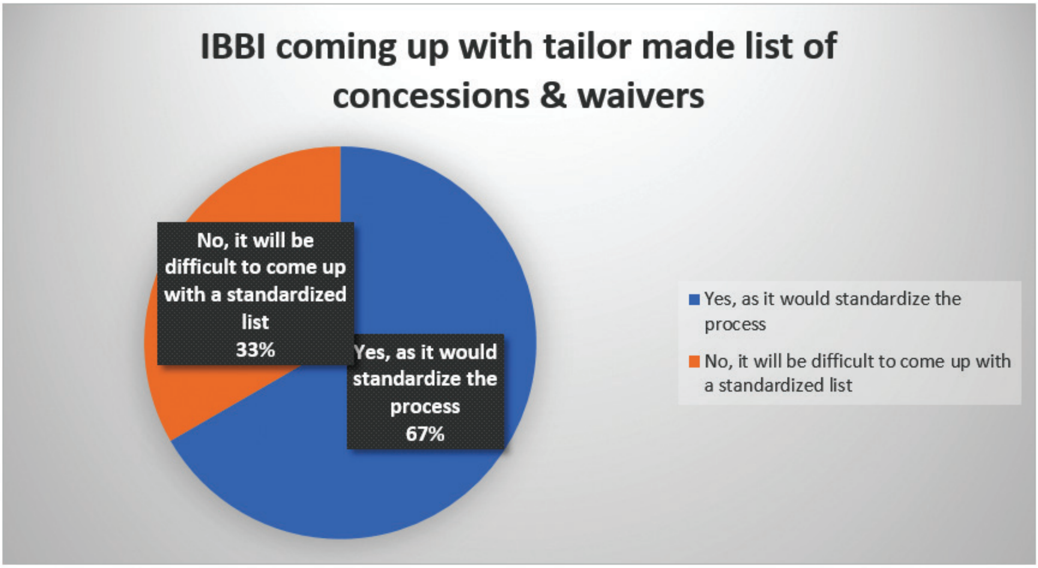


Fig. 9. *The graph depicts that majority of the respondents are of the view that such tailor-made list would standardise the process.*

Therefore, it can be seen that such standardised list can be used to avoid frivolous litigations and would also ensure better quality plans being put forth for approval.

Issue 3

Whether the judgment of the Hon'ble Supreme Court in *Ebix*, sets the clock backwards on the concept of economic legislation, and essentially imposes a legal remedy to a rather economic problem?

The paper delves into the landmark judgment of the Hon'ble Supreme Court in *Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. & Anr,*[20] which throws up novel hurdles for resolution applicants by binding them to a plan which might have become commercially unviable and unfit for implementation. The paper tries to deep dive into the issue and wishes to bring out the resolution applicants' perspective on how a fairly flexible insolvency regime allows adequate elbowroom for experimentation and successful implementation of the plan, as opposed to an ecosystem which by way of a judicial diktat binds the resolution applicants even in an unworkable plan. This essentially takes away the space for experimentation and eventually discourages successful resolution of the CD, which is the cornerstone of the Code.

Our paper was further strengthened by the data received from IBBI demonstrating that on an average the AA is taking more than 200 days to approve a plan, such delay is a major cause of worry for the stakeholders, especially for the resolution applicant who put a lot of investment at stake.

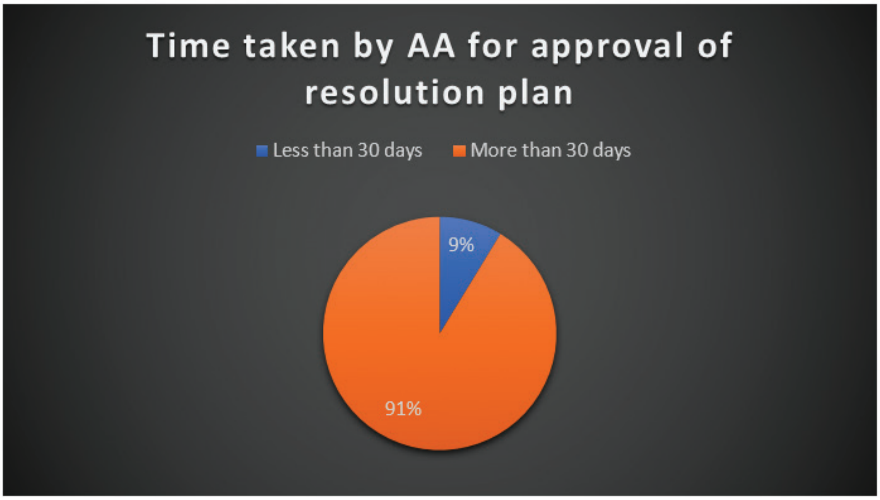


Fig. 10. *Data from IBBI upto 31st December, 2021 showcasing time taken from Hon'ble AA for approval of the plan. Based on the above data it was concluded that the average time taken by Hon'ble AA is more than two hundred days (on an average seven months).*

Judicial Hands-off Qua Economic Legislation

The Hon'ble Apex court in the landmark case of *Swiss Ribbons* held, *'in complex economic matters every decision is necessarily empiric and it is based on experimentation or what one may call trial and error method and therefore, its validity cannot be tested on any rigid prior considerations or on the application of any straitjacket formula'.*[21] Economic and commercial laws have to be dealt with greater liberty. The primary objective of an economic legislation is to accelerate economic growth rather than suspending its growth by doubting its efficacy and leaving no scope for experimentation. The Code was introduced with the intent to provide huge relief to the piled-up NPAs and dignified and easy market exit.

The Code works on creditor-in-possession model; however, the lesser scope of experimentation leads to preferring alternative mechanism by lenders. To get conversant to new law and to see fruits of it, it will take time, but just for the sake of this reason, we cannot wish away the mandate of this nation which has come through Parliament.[22] Therefore, for successful outcome an economic legislation continuous evolution and experimentation 'Code' is the only way out.

Party Autonomy

The lack of party autonomy in a plan is a matter of grave concern. As in most of the cases, it is seen it takes indefinite time for approval of resolution which makes it difficult for implementation of the same. The plan is based on certain projections and assumptions which definitely vary with each passing day.

The Model CIRP timeline mentions ideally the approval of resolution should be completed in about 15 days from the date of application before the AA. Even though, it's only directory in nature yet in real time cases there is a huge lapse of time. Thus, giving an elbow-room to resolution applicant should be the need of the hour. In the survey conducted, it did concur to our view that dynamics of a plan change, many at times making the plan unviable and unfeasible to be implemented.

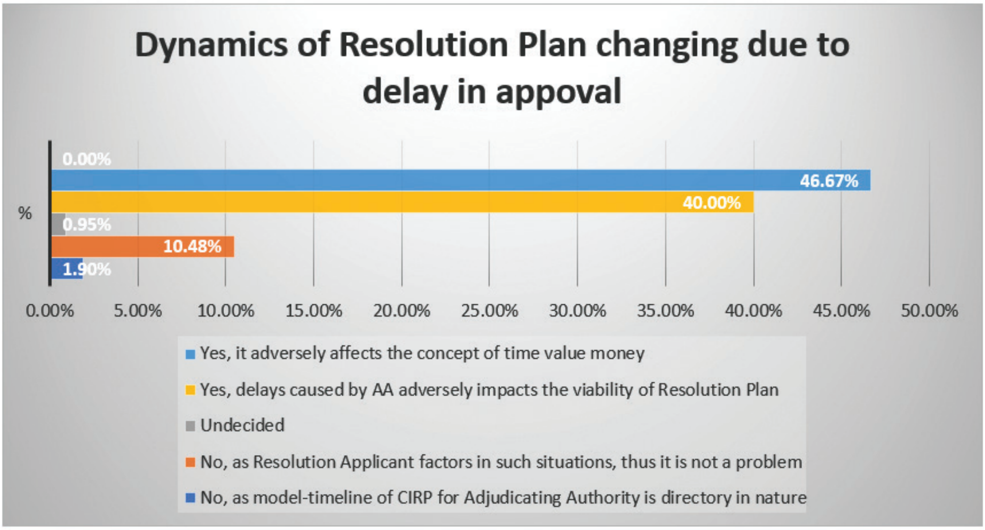


Fig. 11. *Out of the sample survey of 105 respondents, majority stakeholders are of the view that delay in approval of the plan from Hon'ble AA adversely impacts the plan which ultimately changes the commercial dynamics, feasibility and viability of the plan.*

In the absence of any exit route under the Code for a successful resolution applicant is indicative towards vetoing of any attempt of withdraw the plan. The preamble the Code, emphasises on the balancing the interest of the stakeholders. However, the evident imbalance in scale of balance in case of resolution applicant is of grave concern.

The Code emphasises that a plan should be feasible, viable and implementable with specific timelines. The current framework provides for no scope in for further modifications or withdrawals of CoC approved plans. However, the Hon'ble Apex Court exercised Article 142 of the Constitution in the matter *Kundan Care Appeal*[23], allowed modification of the plan at the behest of the creditors for further revision of the plan, and in the event, there is any disagreement on revised plan, then the original plan shall prevail and the same needs to expeditiously, and preferably within a period of two weeks from the date of receipt of an application from the RP[24]. While pronouncing the order, the Hon'ble Apex Court has also curtailed the inherent powers of NCLT under section 60(5) of the Code by clipping its wings in allowing any modification or withdrawal of the plan. The precedent curtails the scope of inherent powers of AA to use power even in exceptional circumstances. However, cases such as *Kundan Care Appeal*, enforces the point if the CoC keep the larger goal in mind which is put back the bleeding CD on its, such unique options can be explored.

In the matter of *Ebix*, a period of 18 months had passed from the date of submission of the plan (i.e., February 19, 2018) and 27 months from the CIRP[25]. Despite the inordinate delay in approval of the plan and material change in financial projections of the plan. The focus solely lies on implementing the plan even though its unviable or unworkable in the current scenario. It is an instance where inequitable and unjust and evasive attempt is being made to put the CD on its feet. Material adverse change enables a party to withdraw from a contract in circumstances where there is a material change after its signing[26]. This essentially reflects the allocation of risks between contracting parties. The complete disregard of change in financial projections and material adverse change will further harm economy *vis-à-vis* the Code.

UNICITRAL legislative guide on insolvency framework is silent on the aspect of modification of plan, however, it puts focus the respective jurisdiction to adopt a framework which is consonance with public policy. As mentioned earlier the Indian economy is shifting to marketism. Therefore, keeping an elbow-room for evolving and experimenting will more chance to boost the economy. Emerging Asian market like Singapore has left room for substantive ways in which a plan can be reviewed, even though the average time taken for insolvency resolution is 8 months[27]. The resolution applicant, however, cannot back out of the plan, though its implementation may fail to resolve the company, resources infused under the plan may go down the drain, probably dragging the applicant into insolvency[28].

Scope of distressed market

Though in last 25 years, along with the growth of specialised financial intermediaries like ARCs and recently introduced Special Situations AIFs, have made it increasingly feasible for sophisticated investors to bring in resources for reconstruction, and take measures to address the NPA issue[29]. On the one hand there is a dearth of capital among the intermediaries in the NPA resolution process, on the other hand there are stressed assets funds and investors looking for opportunities to invest[30]. Therefore, the two have complimentary role and can take the markets to the next level.

With the introduction of the Code, the latitude of stressed asset market widened up. The unique feature of the Code is strict timelines mandated in the Legislature, however the same not adhered to, this is clearly visible from the survey we conducted, which compliments the finding made from the IBBI date depicted in Fig. 10 above.

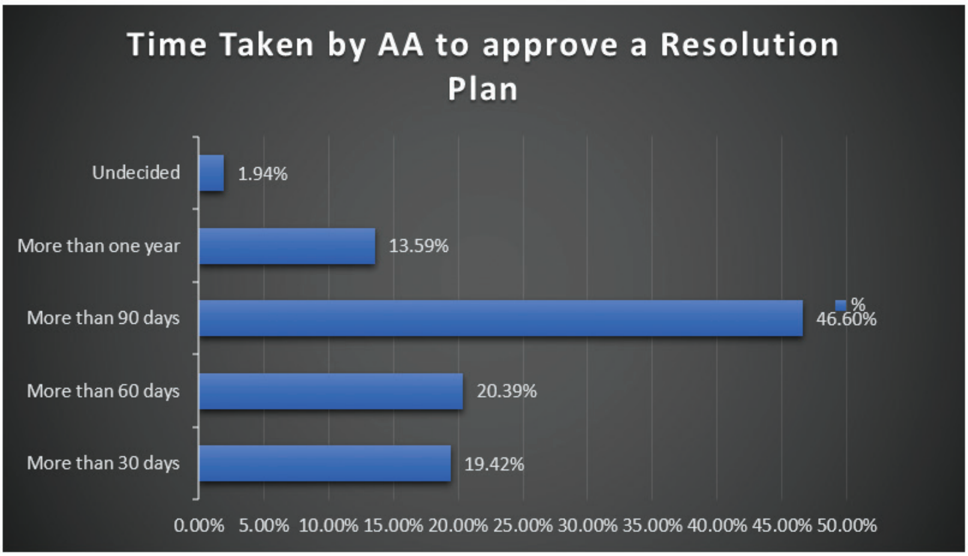


Fig. 12. *Out of the sample survey of 105 respondents, majority stakeholders have experienced that it takes more than 90 days for approval of the plan, than ideally being approved within 30 days.*

On comparing the IBBI data and the survey data, it clearly depicts there is a complete deviation from the prescribed timeline. This definitely defeats objective of the Code which is timely resolution of the CD.

Time is of the essence under the Code, which ultimately gives the investors a sense of hold on the market, this was succinctly captured in the observations made by the Hon'ble Supreme Court in the case of *Amtek Auto*[31], any deviation in timeline defeats the purpose of the Code. As it is an enormous risk a prospective resolution applicant, further delving from the timeline will decrease the risk appetite of the investors, resulting in drying up of plans and consequent liquidation or even viable companies may turn into unresolvable. Therefore, there should enough scope of experimentation in an economic legislation that it does not slide back to the earlier centuries rather harmonises with fast pace moving markets.

Recommendation

The paper therefore proposes following amendment by inserting a proviso to sub-clause (1) section 31 of the Code:

> Provided, where the Adjudicating Authority takes more than six months to approve a resolution plan, the successful resolution applicant shall have the right to approach the Adjudicating Authority for further modification of the resolution plan, subject to the Committee of Creditors approval.
>
> Provided, where the Adjudicating Authority takes more than one year to approve a resolution plan, then the successful resolution applicant have the right to withdraw the resolution plan. Provided that resolution plan passes the litmus test of absolute unviability of plan, subject to Committee of Creditors approval.

This shall act as a deterrent to keep the Hon'ble AA in check to adhere to the strict timelines prescribed in the Code and amendment shall be *'mandatory'* in nature.

If the Code has be to relevant with times then the only way forward is through constant introspections and revisions. The Code being an economic legislation should be free from all kinds of socialist tutelage this shall also help to develop robust market for stressed assets.

CONCLUSION

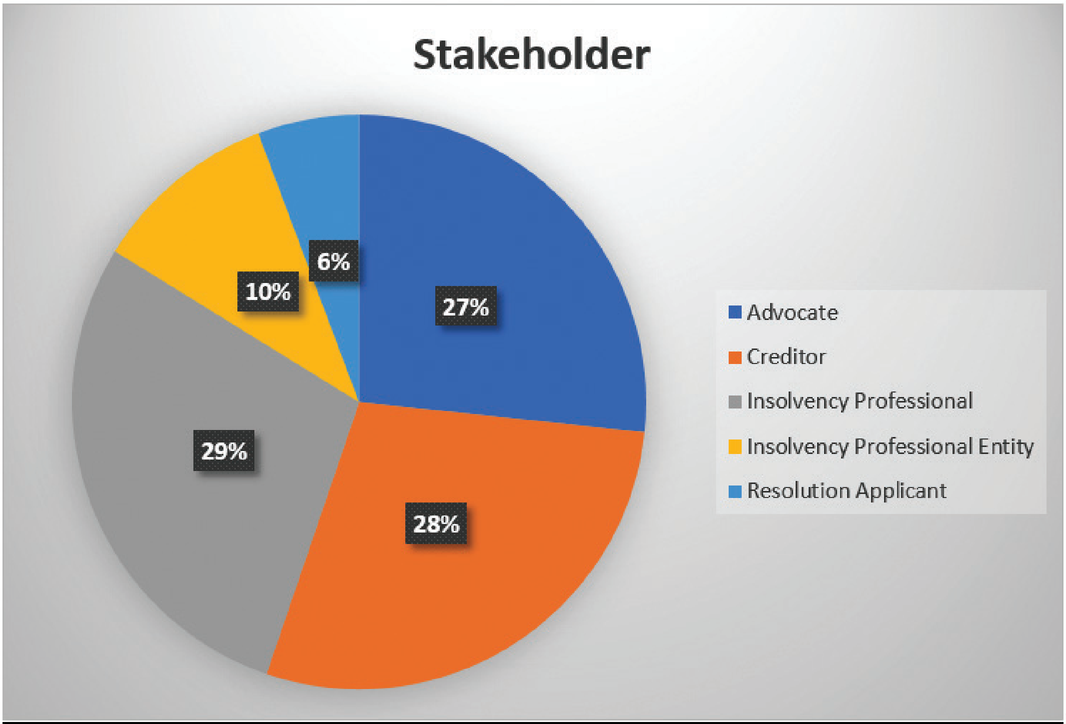
The paper has ardently strived to identify and assess the issues raised for contemplation of relevant stakeholders; the purpose was to raise issues of concern that could be addressed at the relevant forums. The paper therefore concludes that there is an immediate need for provisions of interim-moratorium in order to better facilitate speedy resolution and abate opportunistic behaviors of both creditors and promoters. This ensures a consolidates '*in rem* process' is adhered to, this would disincentive creditors from appropriating assets of the CD and would incentivise them to actively engage in the process.

The paper furthermore proposes that the negative list of concessions and waivers could be used as an indicative list for prospective resolution applicants to not seek frivolous concessions and also be very mindful if they are seeking deemed approvals and condition precedents in the plan.

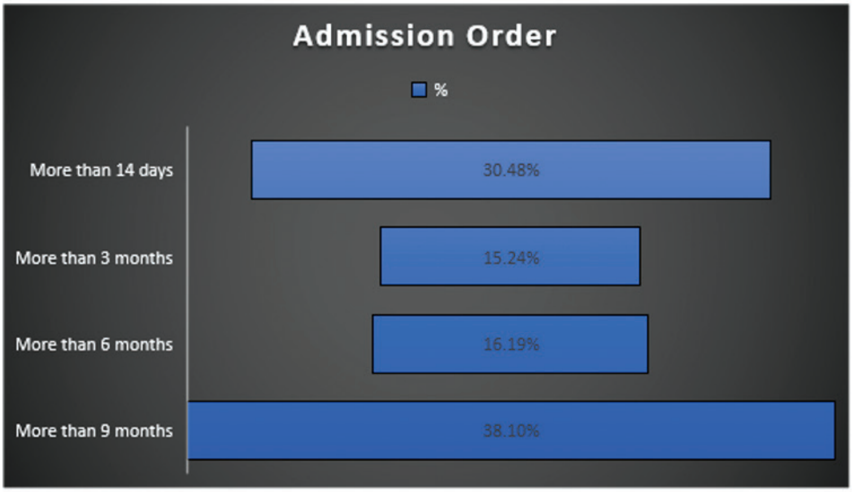
The Code is an economic legislation which requires continuous experimentation and evolution with each passing year to meet the market needs. The time taken from filing of the application for approval of the plan to final order on the same takes more 200 days (approximately taking seven months). However, ideally the order on the approval of the plan needs to complete within 30 days. Consequently, the dynamics of the plan also changes with each passing day. The complete disregard in change of financial projections and material adverse change further harms the economy *vis-à-vis* the Code. Therefore, an amendment is proposed in sub-clause (1) of section 31 of the Code to give the resolution applicant right to modify the plan if the time taken on approval of the plan is beyond six months, provided the CoC approve the same. And if the time taken on the approval of the plan is beyond a year, the resolution applicant should have the right to withdraw the plan, provided it passes the litmus test of absolute unviability and CoC approve the same. Constant introspections and revisions shall aid to better resolution of the Code *vis-à-vis* boosting the economy.

Annexure 1- Survey responses

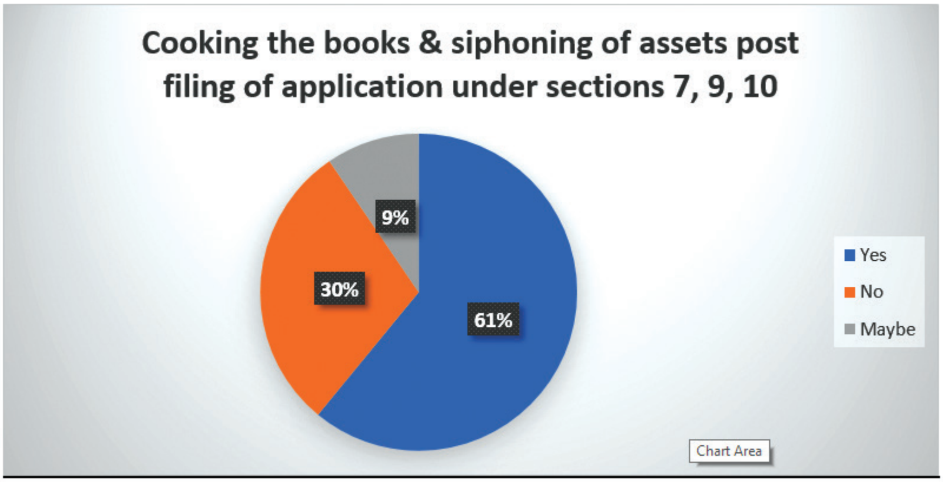
Please identify yourself with the below mentioned stakeholder in the insolvency ecosystem.



1. **How long does the AA take to pass the admission order for CIRP?**



2. **Post filing of application of section 7/9/10 under the IBC, do promoters try to misuse the time at hand to cook the books & siphon of the assets. (if yes, please comment)**

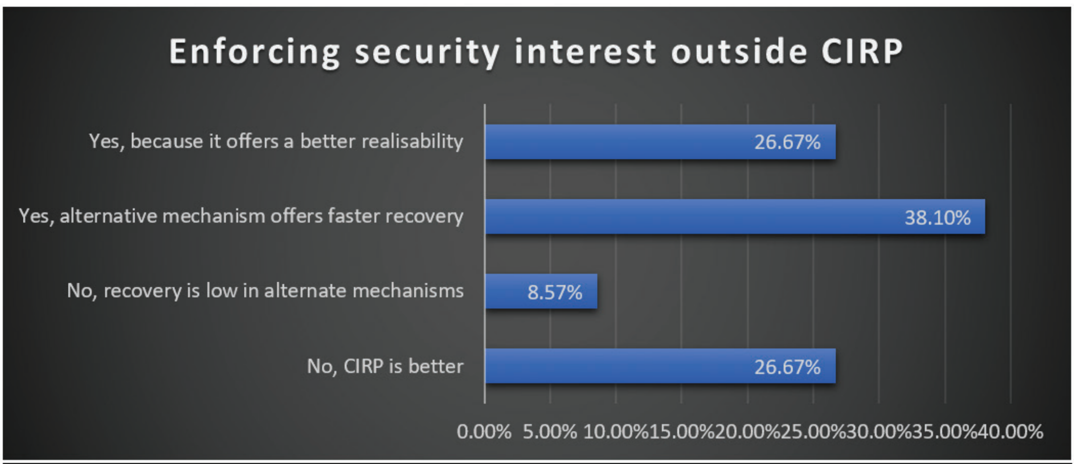


Yes
Generally, the assets are sold off/ transferred before the moratorium kicks in
In few cases.
Sometimes
Not entirely sure, but it's a possibility.
Uncooperative and tries to siphon the assets
Try to misuse the time at hand for their own benefit

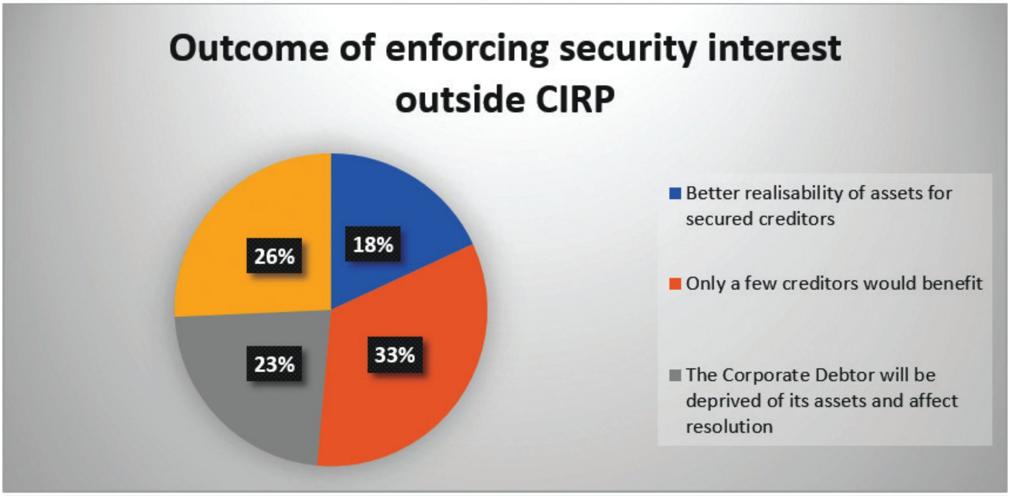
No
As filing of such application does not restrain the CD from discharging of assets till the admission of CIRP and grant of moratorium.
They may try but it is a part of transaction audit to identify.
Probably any such attempt to modify accounts would be prior to applying under section10
But the same can be recovered by filing application under 25(2) j

Maybe
Always try to survive the co. if there is no option to leave the co. in the hands financial creditors
Some do while do not
They try to hide or do not cooperate in sharing records especially when an element of PUFE is involved
Don't know, we have never been able to prove it. But certainly, some time transaction audit does come up with some unresolved issues.
In few exceptional cases
Depends on what kind of promoters you are dealing with. But it can be observed in most of the cases, certain fraudulent transactions, if properly reviewed
It depends on the integrity of the promoters.
Uncooperative
Sale of assets since moratorium is imparted only upon admission

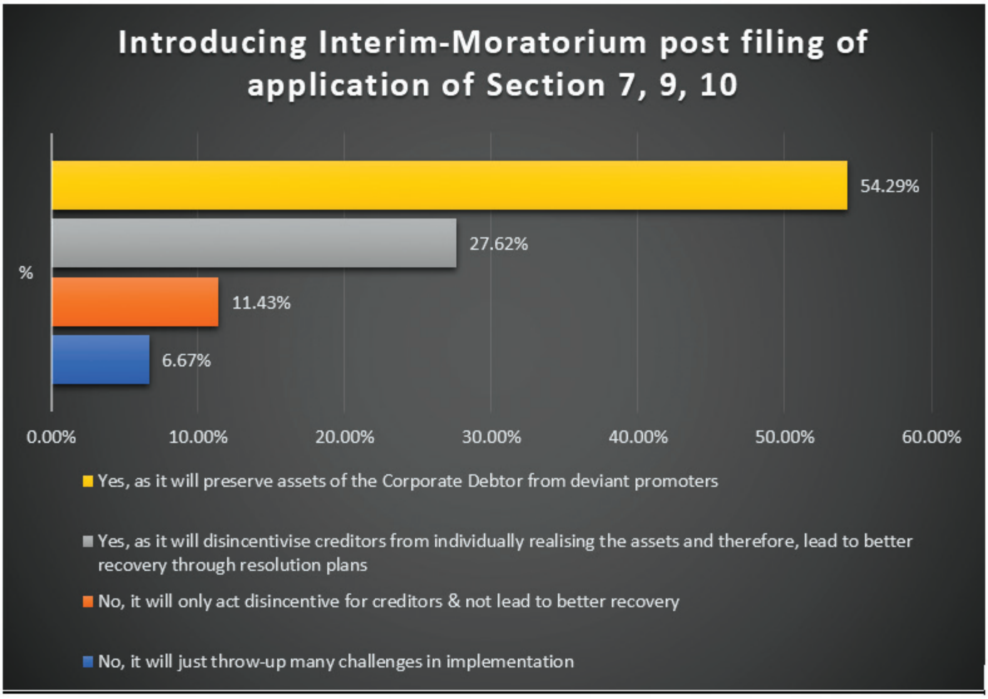
3. As a secured creditor, would you choose to enforce security interest outside of CIRP?



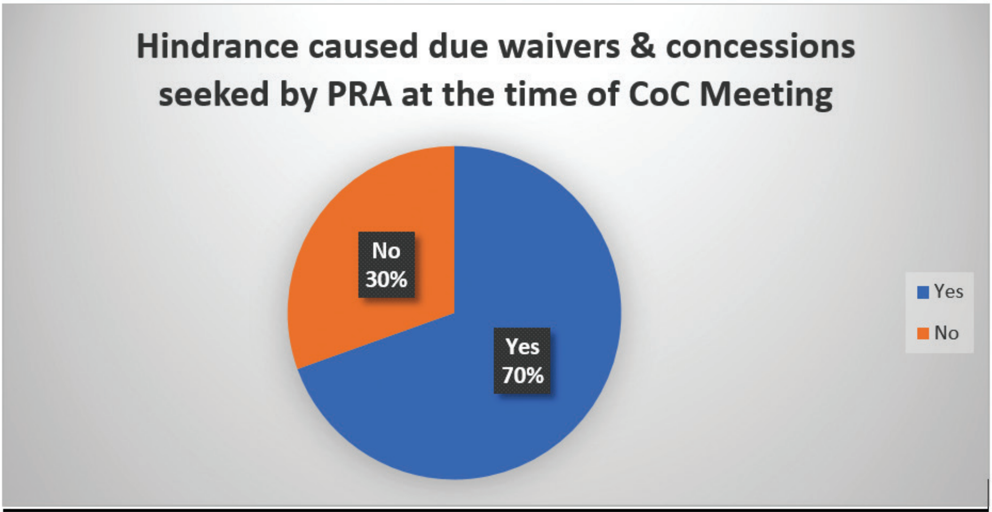
4. What do you believe would be the outcome of enforcing security interest before the initiation CIRP?



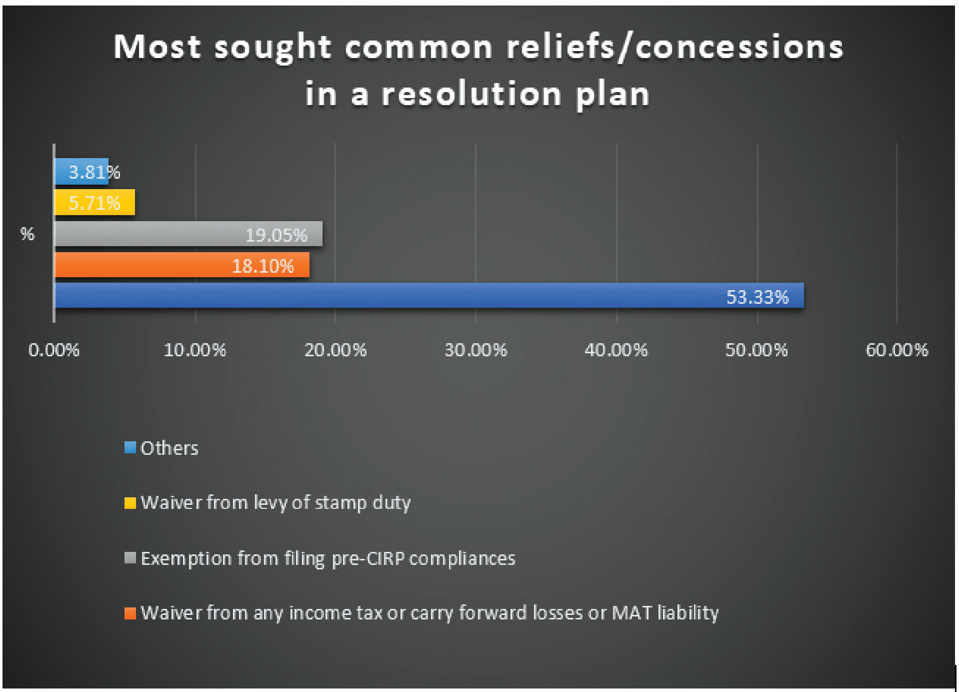
5. Should interim-moratorium be introduced post the filing of section 7, 9 & 10 application under the IBC?



6. **Whether waivers/concessions sought by Prospective Resolution Applicants (PRA) cause hinderance at the time of voting in CoC meeting?**

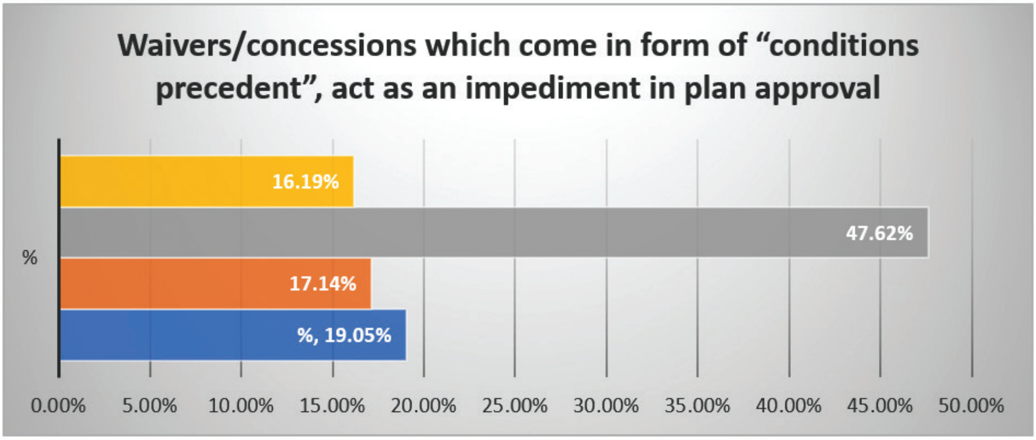


7. **Which are the most sought common reliefs/ concessions in a resolution plan?**

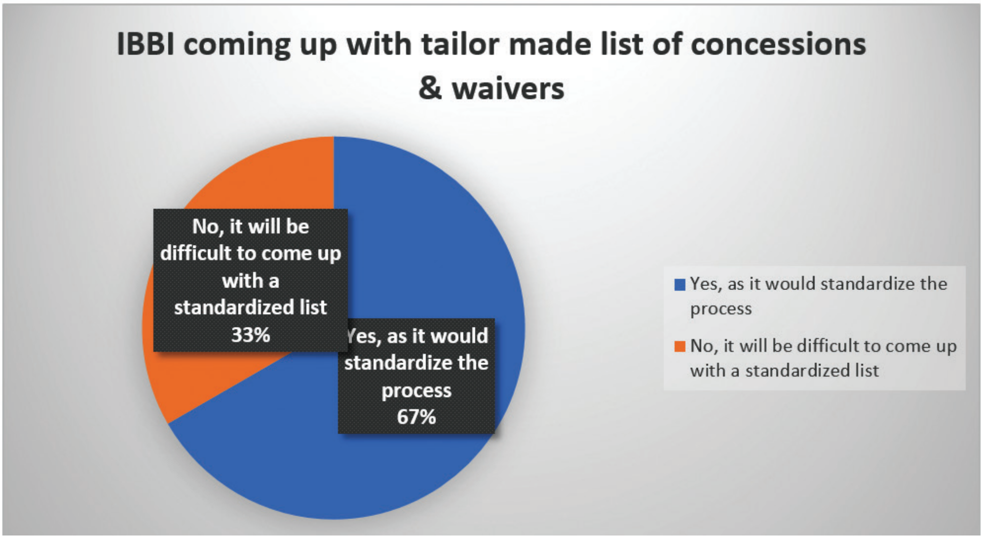


Others
None of the above
All of the above, but it depends on AA. Nowadays AA are also passing orders where consent of respective departments needs to be taken
All creditors will give approval for revival of company or winding of company
All the above depending upon case to case

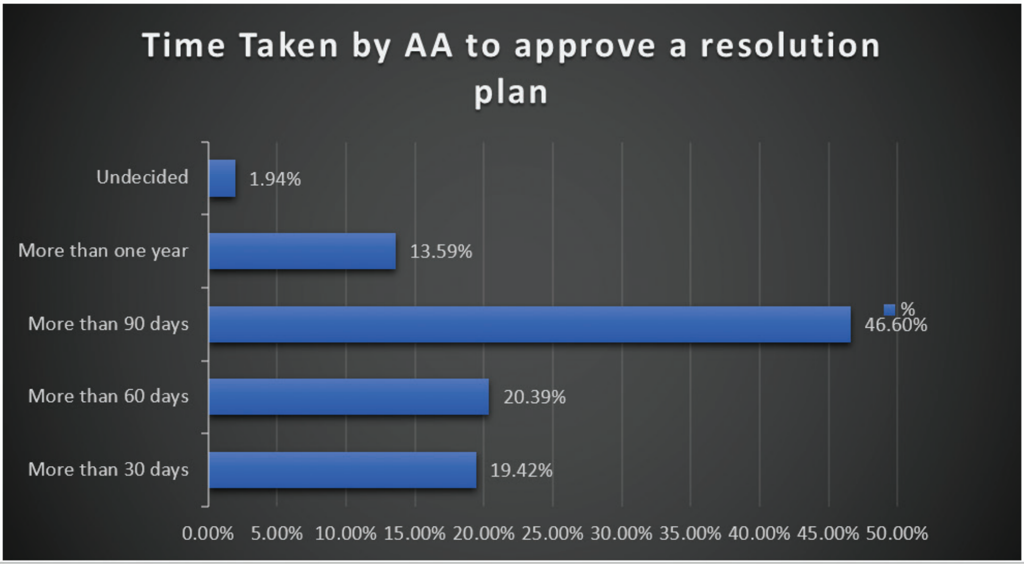
8. **Whether waivers/concessions which come in form of "conditions precedent", act as an impediment in plan approval?**



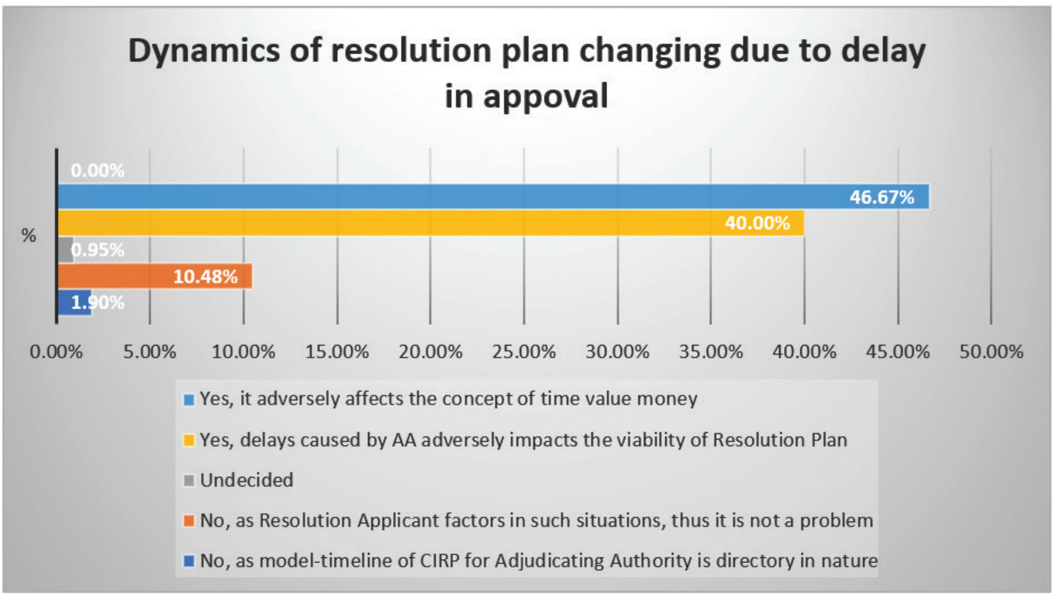
9. **Should IBBI come up with tailor made list of concessions & waivers which should not be sought in a resolution plan?**



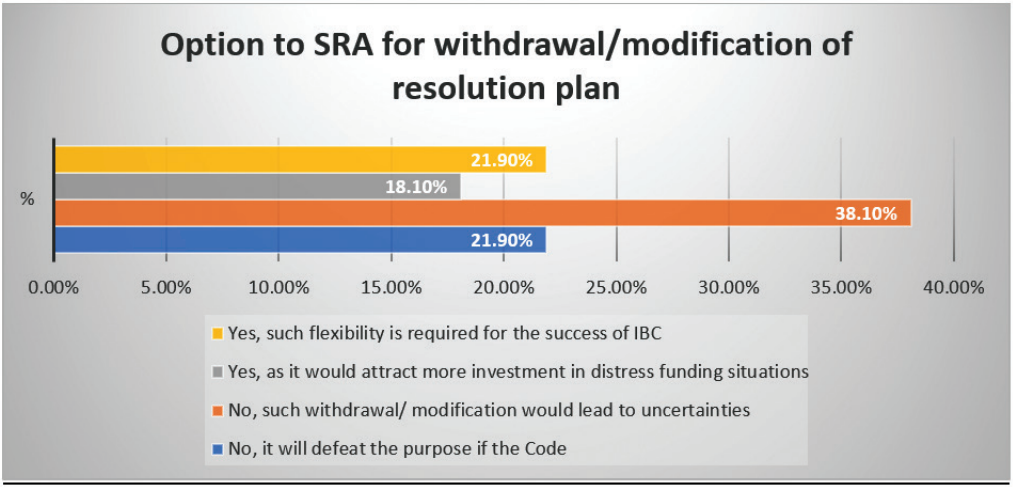
10. **How long does the AA take to approve a resolution plan?**



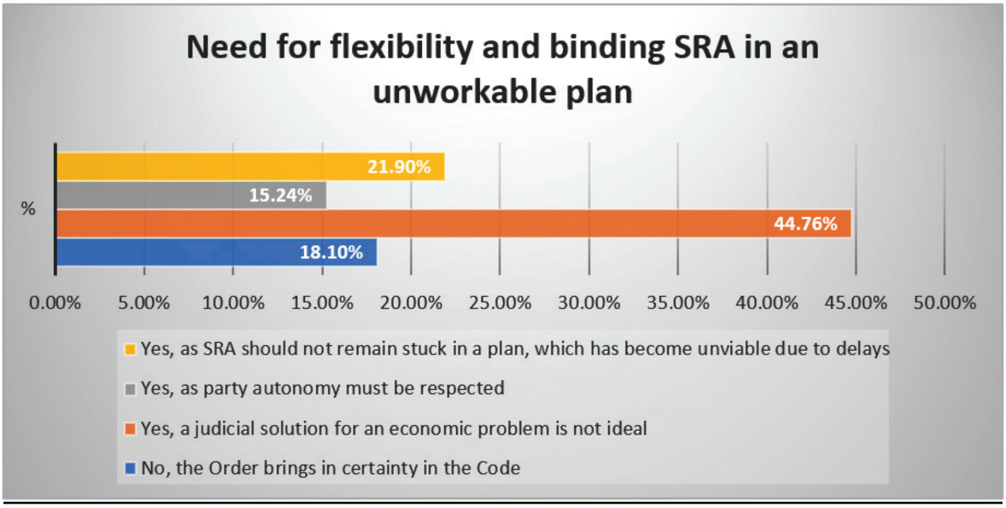
11. **Does such delay adversely affect the investment prospects under the IBC? Further should the dynamics of the resolution plan change with such delay?**



12. Based on the above should the Successful Resolution Applicant ("SRA") be allowed to withdraw/ modify the plan?



13. The IBC is an economic legislation and the stakeholders right to have flexibility is the cornerstone of such legislation. In light of this, whether Supreme Court's Order in *Ebix* takes away the flexibility and binds SRA in an unworkable plan?



Annexure 2- List of judgments (NCLT Kolkata) relied to formulate the list of concessions & waivers

Sl. No.	Name of the judgment	Citations
1	*Bank of Baroda & Anr. v. Kilburn Chemical Ltd*	C.P. (IB) No. 764/KB/2020
2	*State Bank of India v. UIC Udyog Limited*	CP (IB) No. 977/KB/2018
3	*State Bank of India v. Swati Udyog Private Limited*	CP (IB) No.956/KB/2018
4	*Punjab National Bank v. Prithvi Ferro Alloys Private Limited & Ors.*	CP (IB) No.140/KB/2019
5	*Bank of India v. Aeon Manufacturing Private Limited*	CP (IB) No. 683/KB/2018
6	*ATO (I) Limited v. Gandhmardhan Sponge Industries & Ors.*	CP (IB) No. 180/KB/2019
7	*State Bank of India v. Rohit Ferro Tech Limited*	CP (IB) 1214/KB/2018

1 Ministry of Finance Interim Report of the Bankruptcy Law Reforms Committee, February, 2015, p. 13
2 *M/s. Surendra Trading Company v. M/s. Juggilal Kamlapat Jute Mills Co. Ltd. & Ors.*, 2017, 16 SCC 143
3 Report of the Insolvency Law Committee, February, 2020, p. 26
4 Survey results annexed as Annexure 1
5 *Mohanlal Ayyapan Pillai v. Virgo Marine Shipyards & Ors.*, C.P. 1600/I&B/MB/2019
6 Report of the sub-committee of the Insolvency Law Committee for Notification of Financial Service Providers under section 227 of the Insolvency And Bankruptcy Code, 2016
7 Supra Note 3, p. 27
8 *Bank of Baroda & Anr. v. Kilburn Chemical Ltd.*, C.P. (IB) No. 764/KB/2020
9 *Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. & Anr.*, 2021, SCC Online SC707
10 The Chakravyuha Challenge of the Indian Economy, Economic Survey, 2016-17
11 Stiglitz J. (2001), "Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws", Bankruptcy Laws: Basic Economic Principles, World Bank.
12 Supra Note 9
13 The UNCITRAL Legislative Guide on Insolvency Law, December, 2005
14 *Mohanlal Ayyapan Pillai v. Virgo Marine Shipyards & Ors.*, C.P. 1600/I&B/MB/2019
15 *Mohanlal Ayyapan Pillai v. Virgo Marine Shipyards & Ors.*, C.P. 1600/I&B/MB/2019
16 *In re: SEL MANUFACTURING CO. LTD,* Case No. 19-10988 (MFW)
17 Supra Note 1
18 *NUI Pulp and Paper Industries Pvt. Ltd. v. Roxcel Trading GmBH*, Company Appeal (AT) (Insolvency) No. 664/2019.
19 *Punjab National Bank v. Saptarishi Hotels Pvt. Ltd.*, CP (IB) No. 599171HDB/201
20 Supra Note 9
21 *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, (2019) 4 Supreme Court Cases 17
22 *DF Deutsche Forfait AG & Anr. v. Uttam Galva Steel Ltd.*, 2017, C.P. No. 45/I & BP/NCLT/MAH/2017
23 *Kundan Care Products Limited v. Mr Amit Gupta and Ors*, 2020, Civil Appeal No. 3560 of 2020
24 Supra Note 23
25 Supra Note 9
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EXECUTORY CONTRACTS AND INSOLVENCY:

COMPARATIVE STUDY AND RECOMMENDATIONS

— L. Viswanathan, Animesh Bisht and Karan Sangani

Executory contracts are essentially those in which performance (other than payment) remains outstanding at the time of filing of the insolvency petition. At times, the obligation to perform such executory contracts may result in the revival of the debtor becoming unviable. In other cases, where there may have been breaches of such contracts at a pre-insolvency stage which would entitle the counter party to terminate, the continuation of the benefits arising from such contracts may be vital to the revival of the debtor. Thus, the treatment of executory contracts entails striking a balance between contractual autonomy and policy objectives of insolvency regime, as the effective resolution of a debtor would require either preserving value of beneficial contracts or rejecting onerous contracts.

Executive Summary

This paper outlines a conceptual legislative scheme for the treatment of executory contracts in India, by examining the approaches towards executory contracts in the jurisdictions of US and UK and evaluating the policy objectives of the Insolvency and Bankruptcy Code, 2016. Firstly, this paper delineates the meaning and scope of executory contracts as understood in the jurisdictions of the US and the UK. Thereafter, this paper discusses the treatment of executory contracts in the jurisdictions of the US and the UK, and highlights the approaches adopted by the US and the UK regarding the treatment of contractual terms providing for termination or modification of executory contracts on the occurrence of insolvency. Finally, this paper proposes a suitable legislative model for the treatment of executory contracts under the Indian insolvency regime.

Keywords: Insolvency, Executory Contracts, Assumption, Rejection, *Ipso Facto* Clauses.

INTRODUCTION

> *'As India develops into a responsive member of the international community, our laws cannot afford to be inward-looking.'* [1]
>
> *— Justice Dr. D. Y. Chandrachud*

Insolvency regimes across the world recognise 'value maximisation' as the most fundamental and sacrosanct object of insolvency resolution.[2] This is also recognised under the Indian jurisprudence as the core objective of insolvency resolution, with several seminal decisions of Indian courts laying emphasis on the need to 'revive' a debtor with liquidation being the last resort.[3] With consistent emphasis on the 'clean slate doctrine' as the key to the revival of a debtor, the law relating to the treatment of claims and extinguishment of liabilities in an insolvency resolution, is now well settled in India.[4] However, one significant aspect of insolvency resolution, which is often in conflict with the aforesaid principles of 'revival', 'value maximisation' and 'clean slate', is the treatment of executory contracts in insolvency. The treatment of executory contracts is widely recognised as one of the most complex and significant aspects of insolvency resolution.[5] Executory contracts are essentially those in which performance (other than payment) remains outstanding at the time of filing of the insolvency petition.[6] On the other hand, executed contracts are the ones that have been fully performed by both parties,[7] with no outstanding or prospective obligations remaining due under the contract.

At times, the obligation to perform such executory contracts may result in the revival of the debtor becoming unviable. For instance, power distribution companies in India are witnessing severe financial strain, which is significantly attributable to expensive and long-term power purchase agreements.[8] In other cases, where there may have been breaches of such contracts at a pre-insolvency stage which would entitle the counter party to terminate, the continuation of the benefits arising from such contracts may be vital to the revival of the debtor. Thus, the effective resolution of a debtor would require either preserving value of beneficial contracts or rejection of onerous ones.[9] These situations necessarily require balancing of the settled principles of contract law with the special equities of an insolvency regime in order to allow for effective resolution of the debtor. Therefore, a balance has to be struck between the contractual rights of parties and the policy objectives and public interest in insolvency resolution.[10]

This paper proposes to examine these situations, including instances in the Indian context where such conflicts have arisen and have been dealt with, in the absence of a substantive legislative scheme.[11] This paper proposes to conduct a comparative study of the treatment of such executory contracts in insolvency proceedings in the foreign jurisdictions of the US and the UK.

As opposed to India, the US follows the debtor-in-possession model for resolution and reorganisation of businesses under Chapter 11 of the US Bankruptcy Code (Bankruptcy Code).[12] However, it becomes vital to study the US jurisdiction, as the US insolvency regime has most extensively dealt with the treatment of executory contacts and further the objectives of the US insolvency regime are analogous to the objectives of the Indian Insolvency and Bankruptcy Code, 2016 (IBC/Code).[13] This paper further studies the treatment of executory contracts in the jurisdiction of the UK, as the Code draws heavily from the UK Insolvency Act, 1986 (UK Insolvency Act).

The variation in approaches in such jurisdictions would be the basis for examining and outlining a conceptual legislative scheme that may be adopted in the Indian context. The comparative analysis will highlight how such jurisdictions have sought to balance and resolve the conflict between the fundamental principles of contract law with the policy and core objectives of the insolvency regime. Firstly, this paper discusses the relevance of executory contracts in the context of insolvency law and the meaning and scope of executory contracts as understood in the jurisdictions of the US and the UK. Thereafter, this paper discusses the treatment of executory contracts in the jurisdictions of the US and the UK. Subsequently, this paper highlights the approaches adopted by the US and the UK regarding the treatment of contractual terms providing for termination or modification of executory contracts on the occurrence of insolvency. Finally, this paper proposes a suitable legislative model for the treatment of executory contracts under the Indian insolvency regime.

EXECUTORY CONTRACTS IN INSOLVENCY – RELEVANCE AND SCOPE

Broadly speaking, an ‘executory contract’ refers to a contract, wherein the obligations remain to be performed.[14] Executory contracts represent a form of hybrid property, as the rights accorded under the contract would be deemed to be a property of the debtor company, whereas the duties under the contracts would constitute claims against the debtor company.[15] In addition, these rights and duties are closely interlinked and the effectuation of the rights under the contract would necessarily entail the assumption of the duties under the contract. As a result, determining the value of executory contracts is far more intricate than determining the value of other properties and claims, as it would require assessment of the proceeds obtainable from realisation of rights as well as the cost of assumption of obligations.[16] It is further pertinent to highlight that in the context of insolvency law, the debtor’s evaluation to assume (i.e. continue) or reject (i.e. breach) a contract is not similar to any ordinary contractual party outside the insolvency regime. Rather it is influenced by the special equities of the insolvency regime given that the claim of the counterparty will be settled for pennies on the dollar.[17] Therefore, under any insolvency regime, there exists a fundamental need to examine and provide a mechanism where such contracts can be identified with certainty and thereafter be assumed or rejected.

In this light, defining and understanding the scope of ‘executory contracts’ is of critical importance and a threshold question in the context of treatment of such contracts in insolvency proceedings. What should be considered as an executory contract has a direct bearing on appreciating the accompanying rights that should be available in insolvency proceedings to assume or reject such contracts and even to invalidate certain clauses providing for termination of such contracts.

US experience in defining executory contracts

While ‘executory contracts’ have not been defined under the Bankruptcy Code, the bankruptcy jurisprudence in the US has extensively dealt with the scope of executory contracts.[18] Section 365 of the Bankruptcy Code, titled as ‘executory contracts and unexpired leases’, enables the debtor or the trustee to assume or reject any ‘executory contract’ or unexpired lease subject to court’s approval and other restrictions set out in section 365 of the Bankruptcy Code.[19] Section 365 espouses the principle that the debtor or the trustee should retain the capability to reject the performance of onerous contracts and assume the advantageous contracts.[20] It is in this context that the task of defining ‘executory contracts’ or what contracts should form the subject-matter of the powers available under section 365 fell to the courts and resulted in the emergence of varying interpretations and approaches in relation to the meaning of executory contracts.[21]

The courts in the US have traditionally used Countryman's definition, as it is commonly known, to define 'executory contracts'.[22] Propounded by Professor Vern Countryman, it defines executory contracts as contracts under which *'the obligations of both the bankruptcy and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other'.*[23]

This definition to determine the executoriness of a contract is also referred to as the 'material breach test', as it focuses on examining whether both parties have substantial outstanding obligations that remain and which if not performed by either party would constitute a material breach of the contract.[24] The Countryman's definition is, therefore, a gating mechanism, whereby in order for a contract to qualify as being amenable to assumption or rejection under section 365, it must first meet the threshold requirement of 'executoriness'.[25]

While seemingly straightforward, the requirement of a 'material' breach of obligations has generated uncertainty in its application to intricate contractual arrangements.[26] For example, option contracts would not constitute an 'executory contract' under Countryman's definition, as the failure to exercise the option would not be deemed as a material breach.[27] Also, Countryman's definition would not include contracts where only unilateral obligations remain to be performed, such as non-compete agreements, wherein only one party would have outstanding obligations under the contract.[28]

In view of the limitation of Countryman's definition in covering certain kinds of contracts and inconsistencies in application, a 'functional approach' to executory contracts was proposed by Professor Jay Wesbrook. In this approach, the requirement to meet the threshold standard of 'executoriness' to assume or reject contracts in insolvency is done away with. This approach is instead premised on the economic benefit available to the debtor on assuming or rejecting the contract.[29] As per Westbrook, if there are any outstanding obligations under the contract, then it will be deemed as an executory contract and the rejection or assumption of the contract should favour the estate.[30] Thus, the functional test aims to depart from Countryman's definition of determining 'executoriness' as a threshold test and intends to solely examine if there is any outstanding obligation under the contract.

In this context, it may be noted that the courts have generally adduced the following in relation to the scope of executory contracts:

(a) contracts, where the unperformed obligations entail only payment of money, are not executory contracts;[31]

(b) contracts, where the obligations are substantially performed, are not executory;[32]

(c) contracts, no longer in force, cannot be termed as executory contracts;[33]

(d) contracts, which entail 'mere formality' for performance, are not executory contracts; [34]

(e) unperformed contracts, which are terminated prior to the filing of bankruptcy proceedings, cannot be termed as 'executory contracts' for the purposes of section 365 of the Bankruptcy Code;[35]

(f) intellectual property licensing contracts, franchise contracts and long-term supply contracts are generally regarded as executory contracts.[36]

It is pertinent to note that in 2011, American Bankruptcy Institute had constituted a Commission to Study the Reform of Chapter 11 including the definition of executory contracts. The advisory committee constituted by the Commission had recommended the deletion of the concept of 'executoriness' and the adoption of the functional approach.[37] However, the Commission overruled the recommendation of the advisory committee and favoured the adoption of Countryman's definition. The relevant portions have been reproduced below:

> The Commission found that, although imperfect, the Countryman test strikes an appropriate balance between the rights of debtors in possession and nondebtor counterparties to a contract.[38]

The Commission's recommendation to retain Countryman's definition has been criticised by scholars for its failure to flesh out any substantive reasons for the retention of Countryman's definition and to address its shortcomings in its application to sophisticated contractual arrangements such as option contracts and non-compete agreements.[39] In addition, the increased focus on 'executoriness' has resulted in the emergence of 'zombie contracts', i.e. a contract which cannot be assumed nor rejected, as these contracts do not meet Countryman's 'material breach' test and are deemed to be 'non-executory'.[40] It has resulted in contrasting treatments of seemingly non-executory contracts, as some courts have held that non-executory contracts will 'ride through', i.e. they will survive the bankruptcy proceedings (in other words, they will be deemed to be assumed) – as non-executory contracts cannot be rejected.[41] Whereas some courts have held that non-executory contracts cannot be assumed, i.e. they have upheld the counter of the 'ride through' doctrine (in other words, they will be deemed to be rejected).[42] The said confusion over the scope of executory contracts and the treatment of non-executory contracts has resulted in the creation of a 'legal limbo' in the US bankruptcy jurisprudence.[43]

Therefore, the absence of a clear and coherent definition of executory contracts has resulted in a minefield of contentious litigations in the US. At the same time, it has also raised the fundamental question of whether the retention of the threshold requirement of 'executoriness' is desirable, as it has resulted in subjective approach to executory contracts. In this light, it may be noted that the functional approach does seem to resolve a lot of challenges in relation to the scope of executory contracts and appears well aligned with the object of treatment of executory contracts in insolvency.

UK's approach to defining executory contracts

As opposed to the US, the UK has adopted a limited approach to executory contracts by dealing with only one type and category of executory contracts, i.e., 'onerous contracts'.[44] Section 178 of the UK Insolvency Act permits Liquidators to disclaim 'onerous property' without any permission from the courts. The term 'onerous property' been defined as: '*(a) any unprofitable contract, and (b) any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act'.*[45] Before disclaiming any contract, the Liquidator is required to satisfy the burden that the contract is onerous. The term 'onerous property' includes within its ambit, 'unprofitable contracts', the scope of which was enunciated by the UK Court of Appeal in the case of *SSSL Realisations,*[46] in the following terms:

(a) contracts inflicting constant monetary obligations on the debtor without any reciprocal advantage and to the detriment of creditors;
(b) contracts which may result in future liabilities;
(c) contracts hampering the winding up of the debtor through the means of long-term obligations and expenditure;
(d) the assessment encompasses the nature and the cause of detriment and not merely an analysis of monetary disadvantage;
(e) a contract is not unprofitable merely due to the fact that an alternative arrangement is more beneficial.

It is pertinent to note that the said powers to disclaim onerous contracts have been vested only with the Liquidator under the liquidation proceedings and not with the Administrator under the administration proceedings.[47] Thus, in contrast to the US regime, the UK regime has adopted a limited and circumspect approach to executory contracts.

ASSUMPTION OR REJECTION OF EXECUTORY CONTRACTS

The maximisation of the value of the assets of the debtor is the fundamental objective of any insolvency resolution regime.[48] Assumption of profitable contracts and rejection of onerous contracts in insolvency resolution is a vital mechanism that certain jurisdictions have adopted to achieve this end. These jurisdictions have provided for mechanisms, whereby the trustee or the Resolution Professional (RP) can disclaim the performance of contracts, which are burdensome and would severely strain the assets of the debtor, while permitting the assumption of contracts that are advantageous to the debtor.[49] This paper seeks to extensively discuss the approach followed in the US in this regard. While the UK Insolvency Act does not provide for assumption and rejection of contracts during administration, the treatment of 'onerous contracts' during liquidation under the UK insolvency regime shall be examined to assess if the same principles can also be extrapolated to the administration process.

Assumption or rejection of executory contracts under the US jurisdiction

On the filing of a bankruptcy petition, there is an automatic stay on the termination of executory contracts by the operation of section 362 of the Bankruptcy Code.[50] Section 362(a) of the Bankruptcy Code states that filing of a bankruptcy petition will act as a stay on *'any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate',*[51] and section 541(a) of the Bankruptcy Code defines 'estate' as *'all legal or equitable interests of the debtor in property as of the commencement of the case'.*[52] As discussed earlier, executory contracts constitute a hybrid property where the rights accorded under the contract are deemed to be a property of the debtor. Therefore, the US courts have treated contracts as a 'property' under section 541(a) of the Bankruptcy Code and extended the automatic stay provided under section 362(a) to termination of executory contracts.[53]

With the automatic stay on the termination of executory contracts in place, the trustee or the debtor, as the case may be, can move to assume or disclaim the executory contract with the permission of the court.[54] In this context, it becomes pertinent to understand the true nature of assumption and rejection in the US context as well as the modalities and the effects of the same.

Meaning of assumption and rejection of executory contracts

As the commencement of the bankruptcy petition under the Bankruptcy Code results in the creation of bankruptcy estate, which is a distinct and separate entity from the debtor, scholars have opined that assumption or rejection of an executory contract can be understood in terms of the decision of the trustee or the debtor-in-possession on behalf of the bankruptcy estate to assume or reject the contracts of the debtor.[55] In other words, rejection constitutes the decision of the bankruptcy estate to not become a party to the contract of the debtor, whereas assumption refers to the decision of the bankruptcy estate to undertake the contract on behalf of the debtor. In this light, rejection of an executory contract does not constitute a rescission or termination of the contract by the bankruptcy estate but only permits a breach of the contract, as only unperformed contractual obligations are rejected without any bearing on the already accrued rights and liabilities.[56] In this regard, the US National Bankruptcy Review Commission had noted that:

> Rejection does not "nullify," "rescind," or "vaporize" the contract or terminate the rights of the parties; it does not serve as an avoiding power separate and apart from the express avoiding powers already provided in the Bankruptcy Code.[57]

In order to provide conceptual clarity with respect to the scope of rejection and assumption of contracts, the US National Bankruptcy Review Commission had suggested the substitution of the term 'rejection' with 'election to breach' and the term 'assumption' with 'election to perform'. [58]

Modality of assumption and rejection

In terms of the Bankruptcy Code, the trustee or the debtor may assume or reject the performance of an executory contract: (a) with the permission of the court after providing a notice and an opportunity to be heard before the court to the counterparty; or (b) on the approval of the reorganisation plan providing for the performance of such contract.[59]

Further, as per section 365(b)(1), an executory contract shall be permitted to be assumed by the court if the trustee or the debtor: (a) cures all defaults or gives enough assurance regarding the curing of all defaults; (b) recompenses or gives enough assurance regarding recompensing the counterparty for any monetary loss suffered due to such default; and (c) gives enough assurance regarding the performance of prospective contractual obligations.[60] Therefore, the trustee or the debtor is required to not only cure defaults and assure the performance of prospective obligations but also provide compensation for any past default in the US context. However, section 365(b)(2)(D) provides that the trustee or the debtor is not required to cure a penalty provision regarding default arising from non-compliance with any non-monetary contractual obligation.[61] In addition, the US courts have generally held that non-monetary obligations that are 'non-material' and cannot be cured due to 'impossibility', will not impede the debtor's ability to assume a contract.[62]

On the other hand, the trustee or the debtor, by rejecting an executory contract, essentially declares its intention to not undertake the performance of the unfulfilled obligations under the contract. On the rejection of the contract, the only recourse available to the counterparty is to seek contractual damages against the bankruptcy estate for non-performance of contractual obligations.[63] The rejection of an executory contract constitutes a breach of the contract, which is deemed to take effect from the date instantly prior to the bankruptcy commencement date.[64]

Non-assumable contracts

Section 365(c) of the Bankruptcy Code carves out certain exceptions and provides that the debtor or the trustee cannot assume or assign, *inter alia,* the following executory contracts:

(a) executory contracts, where the party other than the debtor has been excused by the applicable law from accepting performance from or providing performance to an entity other than debtor or debtor-in-possession and such party does not agree to the assumption or assignment of the contract;

(b) executory contracts in relation to providing loans or financial assistance to the debtor or in relation to the issuance of security instruments of the debtor.[65]

With respect to (a), it is stated that contracts pertaining to personal services, partnerships based on personal trust, non-exclusive patents, trademarks, etc., fall within its ambit, as the applicable law makes such contracts non-assignable without consent.[66]

With respect to (b), the policy rationale for making such contracts non-assumable is evident as:

> a party to a transaction which is based upon the financial strength of a debtor should not be required to extend new credit to the debtor whether in the form of loans, lease financing or the purchase of discount notes.[67]

Scholars also argue that the exemption provided for financing contracts is justified, as the Bankruptcy Code provides a comprehensive mechanism for post-petition financing of the debtor.[68]

Partial assumption or rejection is not permitted

On the assumption of an executory contract, the debtor is obligated to perform the contract in its entirety and undertake all the duties set out in the contract. The Bankruptcy Code further requires that at the time of assumption, all past defaults including monetary defaults should be cured along with assuring the counterparty regarding the performance of the future obligations.[69] Therefore, there is no scope for partial assumption or rejection of the obligations under the contract. In instances, where a set of connected agreements constitute an executory contract, the trustee or the debtor will be required to assume or reject all such agreements as a whole.[70]

Time frame available for assumption or rejection of executory contracts

In case of liquidation under Chapter 7 of the Bankruptcy Code, the trustee has been provided with sixty days from the bankruptcy commencement date to either assume or reject the contract failing which the contract will be deemed to be disclaimed.[71]

In case of reorganisation under Chapter 11 of the Bankruptcy Code, the decision regarding the assumption or rejection of the contract is required to be made prior to the confirmation of the plan and the time period provided for the filing of the plan is one hundred and twenty days.[72] However, the court may require the trustee or the debtor to take the decision within a shorter time period on a request by the counterparty.[73] On the conversion of a Chapter 11 case into a Chapter 7 case, the date of conversion will be reckoned as the relevant date to compute the time period of sixty days.[74]

Effect of assumption and rejection of contracts

As has been discussed before, on the assumption of an executory contract, the estate will be liable to perform the whole contract and the liabilities arising on account of the same will be treated as an administrative expense under section 503(b) of the Bankruptcy Code, which will rank in priority.[75] On the other hand, as the rejection of the contract is deemed to take effect from the date immediately prior to the insolvency commencement date, the claim of contractual damages against the bankruptcy estate for non-performance of the contractual obligations will be treated as an unsecured, pre-petition claim under section 365(g) of the Bankruptcy Code.[76] Further, the courts have generally held that any claim arising due to the performance of a contract by a solvent counterparty during the period between the filing of the bankruptcy petition and the date of decision regarding the assumption or rejection of the contract, will be treated as an administrative expense.[77]

The policy justifications for treating the entirety of the liabilities under the contract (including pre-petition liabilities) as an administrative expense on the assumption of an executory contract are generally stated to be as follows: (i) in the context of a debtor-in-possession system, there may be a moral hazard that a debtor may breach contracts and strategically initiate voluntary bankruptcy proceedings with an intention to avoid pre-petition liabilities; (ii) the counterparty which is required to perform the prospective obligations on the assumption of a contract, should be recompensed for past liabilities on 'fairness' grounds; and (iii) failure to provide for curing of past defaults may increase the cost of consideration.[78]

Contracts that are neither assumed nor rejected

As the US bankruptcy regime casts a positive obligation on the trustee or the debtor to either assume or reject executory contracts, there may be certain executory contracts, which may not be affirmatively assumed or rejected under a Chapter 11 case. In such instances, the US courts have applied the 'ride through' doctrine and held that the executory contract survives the bankruptcy proceedings. The operation of 'ride through' doctrine in effect ensures that executory contracts are deemed to be assumed until explicitly rejected.[79]

Standard of proof

The Bankruptcy Code does not explicitly spell out the standard of proof to be applied while assuming or rejecting contracts. Accordingly, the courts have formulated two varying standards of 'burdensome' test and 'business judgment' test while determining the correctness of the decision to assume or reject contracts. While most of the courts have relied on the 'business judgment' test, some have referred to the 'burdensome' test.[80]

The business judgment test is satisfied on it being demonstrated that a rejection or assumption of the contract will accrue a benefit to the estate. In effect, the trustee or the debtor is required to exercise good business judgment to ensure that the estate obtains the maximum benefit out of its contractual obligation.[81]

On the other hand, the burdensome test requires the demonstration of the fact that the performance of the contract will result in losses, and thus, should be rejected. Therefore, under this test, a contract cannot be merely rejected if an alternative arrangement is more profitable and the higher threshold of the assumption of contract resulting in a net loss, should be demonstrated.[82] It has been argued that the business judgment test is in congruence with the Bankruptcy Code, as the language of Bankruptcy Code does not envisage any restrictions on the powers of the debtor or the trustee while rejecting an executory contract other than court approval. The business judgment rule further enables the trustee to maximise the value of the estate.[83]
Therefore, it is evident that the US insolvency regime provides a comprehensive mechanism for the assumption and rejection of executory contracts. From a policy perspective, assumption of executory contracts by the debtor appears to be less of a moral hazard, as there is a complete cure of past defaults and full payment of past dues. On the other hand, there appears to be a more stringent threshold for the rejection of executory contracts, as it requires the satisfaction of either of the litmus tests of 'business judgment' test or 'burdensome' test. In other words, it can be stated that there can be no assumption of executory contracts without cure and there can be no rejection of executory contacts without scrutiny.

Analysing the powers to disclaim onerous contracts in the UK regime

As discussed earlier, section 178 of the UK Insolvency Act permits Liquidators to disclaim 'onerous property'.[84] The modalities and the effects of disclaimer of onerous contracts under the UK insolvency system have been discussed below.

Meaning and scope of disclaimer of onerous contracts

A disclaimer amounts to a unilateral termination of the contract without affecting the rights and liabilities already accrued.[85] The UK Insolvency Act allows the Liquidator to reject any onerous contract without the prior sanction of the court. [86]

The UK Insolvency Act only provides the Liquidator with the powers to reject onerous contracts.[87] The Administrators have only been provided with a restricted right of disclaimer in respect of employment agreements.[88]

However, there has been academic support regarding the grant of powers to disclaim onerous contracts to Administrators during the administration process. The said suggestion is premised on two pragmatic considerations: (i) there may be onerous contracts which may hamper the administration of the debtor; and (ii) disclaiming onerous contracts may promote the effective resolution of the debtor.[89]

In addition, the courts have also reasoned that the Administrator should terminate a contract (even wrongfully) if it is for the benefit of the creditors as a whole. In *BLV Reality Organisation Ltd v. Batten*, the England and Wales High Court held that:

> It may be in the interests of the creditors as a whole that one particular contract with one particular creditor is terminated (even wrongfully): for example if the administrators thought that a particular service could be provided more cheaply or to a higher standard than was currently being done by a creditor with a continuing contract for a service necessary to the on-going trading, with a beneficial result to the creditors as such.[90]

Further, it has been opined that the power to disclaim an onerous contract during administration can also be deduced from the general power of the Administrator to do all acts *'necessary or expedient for the management of the affairs, business and property of the company'.*[91]

Time frame available for disclaimer of onerous contracts

The UK Insolvency Act does not prescribe a timeline within which the Liquidator is required to reject an onerous contract. However, it provides the counterparty with the opportunity to make an application to the Liquidator requiring the Liquidator to take a decision regarding disclaimer.[92] On such an application being made, the Liquidator is required to make a decision within 28 days or such extended period, as may be allowed by the court, failing which the Liquidator will be disentitled from exercising its right to disclaim. As a result, on the failure to exercise the right to reject, the contract is thereafter deemed to be assumed.[93]

Effects of disclaimer of contracts

Any liability arising on account of performance by the counterparty between the insolvency date and the disclaimer date will rank in priority as a liquidation expense.[94] When an onerous contract is disclaimed by the Liquidator, the counterparty will only have the remedy to seek damages or loss as a creditor in the winding up.[95] The UK Insolvency Act further provides that the act of disclaimer will have no bearing on the rights and liabilities of third parties.[96]

Standard of proof

Before disclaiming any contract, the Liquidator is required to satisfy the burden that the contract is onerous. The term 'onerous property' includes within its ambit, 'unprofitable contracts'. As discussed earlier, the scope of the term 'unprofitable contracts' was enunciated by the UK Court of Appeal in the case of *SSSL Realisations.*

Thus, the treatment of executory contracts finds a place in the liquidation context under the UK regime in terms of disclaimer of onerous contracts. Further, even though the UK does not have an explicit mechanism for assumption or rejection of contracts under the administration process, there has been academic as well as judicial support regarding the grant of powers to disclaim onerous contracts to Administrators during the administration process.

TREATMENT OF CLAUSES PROVIDING FOR TERMINATION OR MODIFICATION OF EXECUTORY CONTRACTS ON AN INSOLVENCY EVENT

Anticipating that the initiation of insolvency proceedings may impede the ability of a party to honour its contractual commitments, contracts often include clauses allowing for termination or modification by the solvent party of the contract on the commencement of insolvency resolution proceedings or appointment of Insolvency Professional (IP) in relation to the insolvent party.[97] Contractual provisions allowing for termination of a contract by a party (terminating party) with a counterparty (debtor) on the occurrence or subsistence of events of default relating to application for insolvency, commencement of insolvency resolution proceedings, appointment of IP and other insolvency-related events, are commonly referred to as *ipso facto* clauses in the context of insolvency law.[98] Such clauses have the potential to disrupt the continued performance of contracts to which the debtor company is a party and impede the ability of the debtor company to continue as a going concern.[99] Similarly, certain contractual terms may provide for transfer of property to the solvent party on the occurrence or subsistence of certain insolvency-related events. This may result in the transferred property not being available for realisation for the benefit of the creditors of the debtor.[100]

The approach in the treatment of *ipso facto* clauses in the context of insolvency is not uniform. Certain jurisdictions have invalidated or restricted *ipso facto* clauses providing for termination of contracts on the occurrence or subsistence of insolvency-related events on the rationale that the continued performance of contracts, is crucial for continuation of the debtor company as a going concern and for its effective resolution.[101] On the other hand, some jurisdictions have not expressly legislated on *ipso facto* clauses.[102] Primarily, it is argued that invalidation of *ipso facto* clauses undermines the sanctity of contractual bargain and the freedom of contract.[103] Therefore, the treatment of *ipso facto* carries with it the obvious conflict between the fundamental principles of contract law against the policy and core objectives of an effective insolvency regime.

In relation to contractual provisions providing for transfer of property to the solvent party on the occurrence or subsistence of certain insolvency-related events, the UK has applied the common law principle of 'anti-deprivation', which invalidates contractual clauses providing for unfair withdrawal of property from the debtor on the occurrence of any insolvency-related event.[104] Whereas the US has codified the 'anti-deprivation' principle.[105]

This paper examines the rule on *ipso facto* clauses and the scope of application of the anti-deprivation rule in the US and the UK and how policy considerations have justified the departure from fundamental principles of contract law.

US Position

Ipso facto clauses

Section 365(e) of the Bankruptcy Code sets out the treatment of *ipso facto* clauses in executory contracts and expressly invalidates contractual clauses that permit termination or modification of executory contracts or any rights and obligations thereunder solely due to: (i) the insolvency or monetary position of the debtor prior to the closing of the bankruptcy case; (ii) the initiation of the bankruptcy case; and (iii) the nomination of a trustee or undertaking of possession by a trustee in a bankruptcy case or a custodian before such commencement.[106] It is pertinent to note that only those contractual terms that are based on the aforementioned insolvency-related events are invalidated by the operation of section 365(e) of the Bankruptcy Code. The Bankruptcy Code invalidates such clauses and empowers the trustee to assume and reject executory contracts that will assist the debtor's reorganisation or liquidation.[107]

As discussed in Chapter II, the Bankruptcy Code deems certain contracts as non-assumable. In similar vein, the Bankruptcy Code, on the same policy grounds, has carved out the following exceptions for executory contracts to which the anti-*ipso facto* rule will not be applicable:

(a) executory contracts, where the party other than the debtor has been excused by the applicable law from accepting performance from or providing performance to the trustee or the assignee of such contract and such party does not agree to the assumption of the contract;[108]

(b) executory contracts in relation to providing loans or financial assistance to the debtor or in relation to the issuance of security instruments of the debtor.[109]

Further, certain complex financial market contracts such as securities contracts, commodities contracts, forward contracts, swaps arrangements, repurchase contracts and master netting contracts, are exempted from the automatic stay on termination of contracts and the anti-*ipso facto* rule.[110] In relation to the exemption for complex financial market contracts, the policy justification provided is that these contracts are highly sensitive to the solvency of the party and the insolvency of a counterparty may cause 'chain reaction of insolvencies' and 'pose systemic risks in the financial market place'.[111]

Anti-deprivation rule

Section 541(c) of the Bankruptcy Code codifies the anti-deprivation rule. It provides that the debtor's interest in any asset forms a part of the bankruptcy estate on the bankruptcy commencement date and that any contractual term that prohibits or modifies such transfer or any contractual term that has the effect of modifying, terminating or forfeiting debtor's interest in any asset on the occurrence of an insolvency-related event, is unenforceable.[112] Section 541(c) is of wide amplitude, as any asset in which the debtor has any legal or equitable interest will enter into the bankruptcy estate irrespective of any proprietary or security interest of any other party in such asset.[113] As contractual benefits arising from executory contracts are treated as assets, any contractual term that has the effect of modifying, terminating or forfeiting debtor's interest in such contracts on the occurrence of any insolvency-related event, would fall under the ambit of section 541(c) and be deemed to be unenforceable.[114]

UK position

Ipso facto clauses

Statutory framework for treatment of *ipso facto* clauses is a recent introduction in the UK regime. Pursuant to the Corporate Insolvency and Governance Act, 2020, section 233B was inserted in the UK Insolvency Act to govern the treatment of *ipso facto* clauses. Section 233B(3) of the UK Insolvency Act invalidates contractual terms in contracts for the supply of goods or services to the debtor, providing for termination or any other variance of the contract on account of debtor being subject to insolvency procedure.[115] However, the supplier of goods or services to the debtor may terminate the contract with the permission of the court by establishing that the continued performance of the contract would result in hardship to the supplier.[116] Thus, the UK has tried to preserve some equities by enabling a supplier to terminate the contract if it results in hardship.

Therefore, as opposed to the US, the scope of invalidation of *ipso facto* clauses is limited in the UK, as the anti-*ipso facto* rule is only applicable to contracts providing for supply of goods and services to the debtor and is not applicable to contracts where the debtor is the supplier. It has been argued that permitting solvent parties to rely on *ipso facto* clauses in contracts where the debtor is the supplier, may affect the cashflows of the debtor and jeopardise its ability to continue as a going concern.[117]

Section 233B(4) further restricts suppliers from terminating the contract or the supply during the insolvency process period on account of any entitlement to terminate the contract or the supply arising prior to the start of the insolvency period due to an event occurring prior to the start of the insolvency period.[118] Thus, if the supplier has not acted upon the breach occurring prior to the start of the insolvency period and elected to terminate the contract or the supply prior to the start of the insolvency period, then he cannot exercise the right to terminate the contract or the supply during the insolvency process period. In addition, section 233B(7) further clarifies that the supplier is prohibited from making the payment of any outstanding amount in relation to a supply made to the debtor before the start of the insolvency period as a condition for the supply of goods or services to the debtor after the commencement of the insolvency procedure.[119]

Akin to the Bankruptcy Code in the US, the UK Insolvency Act exempts the following from the application of the anti-*ipso facto* rule:

(a) persons involved in financial services such as insurers, banks, electronic money institutions, investment banks and firms, payment institutions and operators of payment systems, recognised investment exchanges, etc. irrespective of whether such entity is the debtor or the supplier;[120]
(b) contracts involving financial services such as securities contract, commodities contract, futures, forwards, swap contracts, capital market investments, etc.[121]

Anti-deprivation rule

The UK courts have also applied the common law doctrine of 'anti-deprivation', which negates any contractual term that provides for withdrawal of debtor's assets from the insolvency estate on the operation of insolvency. In order to determine the applicability of the anti-deprivation principle, it has to be established that the asset was vested in the debtor and was unjustly withdrawn from the debtor to the detriment of the interests of the creditors.[122]

The English courts have broadly determined the following principles in relation to the applicability of anti-deprivation to different contracts:

(a) conditional sale agreements providing for repossession of goods by the seller on insolvency would not breach the anti-deprivation rule generally. However, a sale of goods on credit without reserving title till payment and providing for re-transfer of goods on insolvency, would be in breach of anti-deprivation rule;[123]

(b) in respect of hire-purchase agreements, the anti-deprivation rule would be breached if the debtor has a proprietary interest in the goods and would not be breached generally if the debtor only has contractual possessory right in the goods;[124]

(c) in relation to retention of title clauses, the same would not normally breach the anti-deprivation rule if the scope of such clause is limited to the original goods supplied. However, retention of title clauses intending to retain title to the proceeds of the goods supplied would be deemed as a charge and would be void for non-registration;[125]

(d) licenses providing for termination on insolvency would not be in breach of the anti-deprivation rule, when the said instruments provide only a limited and determinable interest and not an absolute interest to the debtor.[126]

Thus, the anti-deprivation rule requires the characterisation of contractual interests such as security, personal, proprietary, and quasi-proprietary interest – as the same would determine the questions of ownership of assets and the consequent deprivation. However, the anti-deprivation rule does not interfere with the property right and the security interest of any third party in the asset.[127] It is pertinent to note that the 'anti-deprivation' rule does not operate in relation to arrangements prior to insolvency, as the same falls under the ambit of 'anti-avoidance' rule.[128] Therefore, the English jurisprudence evinces that there exists a lack of doctrinal consistency with respect to the applicability of the anti-deprivation rule to sophisticated contractual arrangements.[129]

PROPOSED MODEL FOR THE TREATMENT OF EXECUTORY CONTRACTS UNDER THE INDIAN INSOLVENCY REGIME

Having examined the treatment of executory contracts in the US and the UK, this paper proposes a legislative scheme for the treatment of executory contracts under the Indian regime. This paper shall discuss and propose:

(a) current treatment and the need to provide a broader framework for dealing with executory contracts under the Indian insolvency regime;

(b) a working definition of 'executory contracts' in the Indian context; and

(c) a suitable legislative model for:

    (i) the assumption and rejection of executory contracts;

    (ii) treatment of *ipso facto* clauses;

    (iii) scope of right of termination by the solvent party on grounds other than insolvency;

    (iv) anti-deprivation rule.

Need to provide a broader framework for treatment of executory contracts in India

Both the UK Insolvency Act and the Code, at present, only deal with a sub-set of executory contracts, i.e., onerous contracts in liquidation proceedings. Regulation 10 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (Liquidation Regulations) permits the Liquidator to disclaim an onerous property or contract by making an application to the adjudicating authority.[130]

Such power to the RP is conspicuous by its absence in the resolution proceedings under the Code. As discussed earlier, the Bankruptcy Code in the US has an extensive mechanism to deal with the assumption and rejection of executory contracts to achieve efficiency and value maximisation in resolution. Broadly speaking, section 365 of the Bankruptcy Code, which deals with the treatment of executory contracts, aims to balance the legislative object of ensuring a successful resolution of the debtor against the contractual rights of the counterparty.[131]

However, there does not appear to be any stated policy justification for restricting the power of disclaimer only to the liquidation setting under the Indian insolvency regime. The Interim Report of the Bankruptcy Law Reform Committee dated February 2015 recommended the following in relation to section 260 of the Companies Act, 2013:

> POWERS AND FUNCTIONS OF THE COMPANY ADMINISTRATOR: **Section 260 should be amended to provide the following powers to the company administrator:**
> General powers in relation to takeover of management (which will include takeover of the company's assets)
>
> - Without prejudice to the powers of the NCLT to direct the company administrator to perform any function, the company administrator shall have the following powers after he has been directed by the NCLT to take over the management of the company:
>
>   ....
>
>   o enforce, modify or terminate any contract or agreement entered into by the company depending on whether such contract is beneficial or detrimental for effectively rescuing the company;[132]

However, the subsequent reports on the insolvency regime, i.e., the Report of the Bankruptcy Law Reform Committee dated November 2015, the Report of the Joint Committee of Parliament dated April 2016 and the Report of the Standing Committee on 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' dated August 2021, do not appear to discuss or delve further into this issue.[133]

In fact, there appears to be no cogent rationale for limiting the powers to disclaim onerous contracts only to Liquidators under the UK regime as well. As discussed earlier, there appears to be growing judicial as well as academic support for extending the powers to disclaim onerous contracts to Administrators in the UK on the grounds that: (i) there may be onerous contracts which may hamper the administration of the debtor; and (ii) disclaiming onerous contracts may promote the effective resolution of the debtor.[134]

Several resolution processes conducted under the Code have raised these questions, where in the absence of a clear legislative framework, the Indian courts often found powers to be insufficient to provide an effective solution and balance contractual obligations with the necessary equities of insolvency.

In *Standard Chartered Bank DBS Bank Limited v. Ruchi Soya Industries Limited,*[135] the National Company Law Tribunal (NCLT), Mumbai did not allow unilateral modification and termination of contracts by the Resolution Applicant (RA) and held that:

> Concerning the relief sought in clause 8.1.10 regarding modification, change, or termination of the contract entered by the Corporate Debtor, with either related party or unrelated party of the Corporate Debtor or existing promoters, no unilateral right of modification, change, or termination of contract can be allowed. However, the Resolution Applicant may modify, change or terminate any contract as per the due process of law.

Similarly, in *DBM Geotechnics and Constructions Private Limited v. Dighi Port Limited,*[136] the NCLT, Mumbai held that:

> We are of the considered view that the resolution applicant in its resolution plan, cannot seek to terminate agreements that have created legal rights in third parties without adhering to the due process of law by which those agreements could have been terminated in case there was no CIRP in place. Such termination of legally binding agreements would violate the law under which such contracts are governed and thus in violation of section 30(2)(e).

However, in *State Bank of India v. Bhushan Steel Limited,*[137] the NCLT, New Delhi approved a resolution plan providing for termination of power purchase agreements between the debtor and a shareholder cum creditor on account of them being onerous. While permitting the termination, the NCLT placed reliance on regulation 39(6) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), which provides that:

> a provision in a resolution plan which would otherwise require the consent of the members or partners of the corporate debtor, as the case may be, under the terms of the constitutional documents of the corporate debtor, shareholders' agreement, joint venture agreement or other document of a similar nature, shall take effect notwithstanding that such consent has not been obtained.[138]

Thus, reliance was sought to be placed on regulation 39(6) to justify the termination of a contract of a shareholder/creditor in the absence of a legislative framework.

Thus, in the absence of a comprehensive legislative framework, judicial variances regarding the treatment of executory contracts will persist and cause an erosion in the value of debtors undergoing insolvency under the Code due to the prolonged litigation regarding the treatment of such contracts. Maximisation of the value of the assets of the debtor is now well entrenched as one of the primary objective of insolvency resolution under the Code.[139] Several seminal decisions of Indian courts have continually emphasised the need to 'revive' a debtor with liquidation being the last resort.[140] Therefore, keeping the primacy of these objectives in mind, a regulatory framework for the rejection and assumption of executory contracts would appear to be necessary to achieve increased efficiencies in resolution process, maximise value in the resolution and ensure the continuation of the debtor a 'going concern'. Therefore, principally, there are valid justifications for the Indian insolvency resolution framework to also incorporate a statutory framework permitting some flexibility in assumption and rejection of executory contracts. Of course, necessary checks and balances to prevent abuse as well as to preserve the equities of the counterparty, as far as possible, in an insolvency scenario, would also be necessary.

Proposing a working definition of 'executory contracts' in the context of India

A legislative scheme for the treatment of executory contracts under the Code, would greatly benefit from a codified definition and a test for identification of executory contracts which would be available for assumption and rejection.

A wider approach to executory contracts

The term 'onerous property' operates in a limited sphere, as it essentially operates as a threshold for rejection of contracts. Regulation 10 of the Liquidation Regulations specifies 'onerous property' as '*(a) land of any tenure, burdened with onerous covenants; (b) shares or stocks in companies; (c) any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or (d) unprofitable contracts*.'[141] Upon an application by the Liquidator, the NCLT may approve the disclaiming of any onerous contract.[142] Under section 535 of the Companies Act, 1956, a similar provision for disclaiming of onerous contracts was available to the Liquidator under winding up proceedings.[143] The Supreme Court, in *Union Bank of India v. Official Liquidator,* while examining power to disclaim contracts under section 535, observed as follows:

> The power Under Section 535 is not to be lightly exercised. Due care and circumspection have to be bestowed. It must be remembered that an order permitting disclaimer, while it frees the Company in liquidation of the obligation to comply with covenants, puts the party in whose favour the covenants are, to serious disadvantage. The Court must therefore, be fully satisfied that there are onerous covenants, covenants which impose a heavy burden upon the Company in liquidation, before giving leave to disclaim them.[144]

Accordingly, the power to disclaim onerous contracts is to be judicially exercised after due consideration by the courts.[145] Ramaiya's Guide to the Companies Act states the following in relation to onerous property:

> The right to disclaim is a right conferred on the liquidator as such, and he can exercise that right only in relation to property which in effect has ceased to be an asset and has become a liability. The right is one which ex natura the company could not enjoy; and it arises for the first time when the company goes into liquidation and a liquidator is appointed.[146]

Thus, restricting the scope of executory contracts to only 'onerous contracts' for the purposes of the corporate insolvency resolution process (CIRP) may only enable the RP to reject certain 'onerous' executory contracts and will fail to provide for any express mechanism for the assumption of executory contracts. The treatment of executory contracts being limited to onerous contracts may work in a traditional liquidation, as there may not be a need to assume contracts given that the Liquidator is only required to crystallise the value of liabilities of the debtor with an aim to efficiently realise the value of assets of the debtor. However, for the purposes of continuing the debtor as a going concern and keeping it viable for revival under the resolution process, assumption of key contracts is critical. As the scope and the objective of the resolution process is wider and distinct from the liquidation process, the scope of executory contracts under resolution process should be able to encompass a mechanism for assumption of contracts as well.

Need to expressly define

As discussed earlier, though the US regime enables the debtor or the trustee to reject or assume an executory contract during the restructuring proceedings of the debtor, the lack of incorporation of a definition of 'executory contracts' in the Bankruptcy Code has generated a divergent jurisprudence regarding the meaning and identification of executory contracts.[147] Therefore, it may be prudent for the

Indian insolvency framework to explicitly adopt and include a definition of 'executory contracts' under the Code to facilitate greater certainty and to limit the scope for divergent judicial positions rather than to leave the task of defining executory contracts to the courts.

Adopting functional approach

Countryman's definition of executory contracts has resulted in subjective approach to executory contracts and has generated uncertainty in its application to contractual arrangements such as options agreements and non-compete agreements.[148] The Commission to Study the Reform of Chapter 11 has also recognised that Countryman's definition has inconsistencies and is not a good fit for some category of contracts such as trademark agreements, options, restrictive covenants, right of first refusal, etc.[149] As opposed to Countryman's definition, the functional approach resolves significant challenges in relation to the scope of executory contracts and appears well aligned with the object of treatment of executory contracts in insolvency. However, the Commission recommended codification of the Countryman's definition, as in the Commission's view, there was already extensive and valuable caselaw available in dealing with executory contracts using this traditional definition.[150]

Given that the functional approach is objective (as it does not go into the question of materiality of obligations) and is in consonance with the value maximisation objective of the Code (with its premise being economic benefit to the debtor), it is proposed that the Indian regime should incorporate the functional approach in dealing with executory contracts. The Commission's recommendation to codify Countryman's definition in the US context was largely in view of the existing jurisprudence which was based on this definition. However, as the Indian jurisprudence has not yet dealt with this issue, it has the flexibility to incorporate the functional approach to executory contracts. Such an approach will be more suitable with the legislative scheme of the Code to ensure maximisation of value, as the RP may assume or reject any contract, where there is any outstanding obligation other than payment obligation under the contract.

Proposing a conceptual framework for assumption and rejection of executory contracts under the Indian insolvency regime

Rejection of executory contracts

Presently, under the Liquidation Regulations, the Liquidator has been provided with the powers to disclaim onerous contracts by giving a prior notice of seven days to the counterparty and making an application to the court within six months from the commencement of liquidation or such longer period, as may be allowed by the court.[151] The Liquidation Regulations further provide that the rights and liabilities of the debtor will be terminated from the date of disclaimer, however, the same will not affect the rights, liabilities and interests of third parties.[152] Further, the Liquidation Regulations provide that the compensation or damages payable to the counterparty on account of disclaimer will be treated as 'any remaining debts and dues' under the distribution mechanism provided under section 53 of the Code.[153]
To bring an efficient and equitable framework for rejection of executory contracts under the insolvency process, necessary checks and balances must also be incorporated to go along with any power that the RP and the RA may be bestowed with while rejecting a contract. The moral hazards of a wide power of rejection are significant, as discussed below. Therefore, it is proposed that the framework for rejection of executory contracts should be limited in scope and should only provide a mechanism for rejection of executory contracts that are onerous in nature. Such an approach balances the special equities created

under the insolvency jurisprudence against the existing contractual jurisprudence and minimises the moral hazards stemming from rejection of contracts.

Minimising the moral hazards of rejection of contracts

Treatment of executory contracts under insolvency proceedings necessarily conflicts with the sanctity of contractual arrangements and party autonomy. This becomes more glaring in the Indian context pursuant to the Specific Relief (Amendment) Act, 2018, wherein the right to seek specific performance of the contract has become a general rule.[154] The right to seek specific performance will be nullified on the rejection of contracts under insolvency proceedings, as the only remedy available to the counterparty would be to seek damages as an unsecured creditor against the debtor. Even these damages, in most cases if not all, would only fetch pennies on the dollar as a claim under insolvency proceedings.

Jurists have consistently expressed concerns regarding the carte blanche provided to the trustee or the debtor in the US in relation to rejection of contracts, as it entails a moral hazard of a debtor breaching contracts and strategically initiating voluntary insolvency proceedings with an intention to wriggle out of contractual obligations. Some scholars have denounced the mechanism of rejection provided under the US regime and have highlighted that *'thousands of bankruptcy cases are filed each year for the primary purpose of rejecting executory contracts.'* [155]

Further, given the unorganised and MSME sector, which is a significant characteristic of the Indian economy, a wide and unchecked power of rejection may have undesirable and adverse effects on such sector.

Therefore, while providing powers of rejection, it is necessary to ensure that such provisions do not become a 'device' to overcome contractual obligations and cause undue hardship to the counterparty. The right of rejection should, therefore, be regulated, and its scope restricted to cases of executory contracts that are onerous.

In addition, given that the decision to reject an onerous contract is a commercial decision, the same power, when being exercised by the RP, would require the approval of the committee of creditors. In addition, akin to the US regime, the said rejection should be subject to the approval of the court in order to ensure necessary checks and balances.

Assumption of executory contracts

Presently, there is a limited mechanism provided under the Code for the assumption of contracts. Section 14 of the Code invalidates the termination of supply of essential goods or services to the Corporate Debtor (CD) during the moratorium period.[156] The essential goods and services refer to electricity, water, telecommunication services and information technology services to the extent that the same does not constitute a direct input to the output generated by the debtor.[157] Further, *vide* the Insolvency and Bankruptcy Code (Amendment) Act, 2020, section 14 has been amended to invalidate the termination of supply of goods or services deemed to be critical by the IP to protect and preserve the value of the debtor and manage the operations of the debtor as a going concern during the moratorium period except when the debtor has not paid dues arising from such supply during the moratorium period.[158] The scope of the assumption power provided under section 14 of the Code is limited, as: (a) it only provides for assumption of contracts pertaining to supply of essential or critical goods and services; and (b) it does not provide the RA with the powers to assume such contracts and would invariably require the RA to negotiate with such parties for the supply of goods and services during the post-CIRP scenario. In addition, the Insolvency Law Committee Report dated February 2020 did envisage that termination may be possible in certain circumstances other than non-payment of dues, which may be provided by way of subordinate legislation.[159] However, at present, there appears to be no subordinate legislation provided in this regard though section 14(2A) permits subordinate legislation on it.[160]

As opposed to the US system, it is proposed that the Indian regime should provide a limited right to assume contracts that are central to the CIRP, i.e., failure to assume those contracts would jeopardise the successful resolution of the debtor company. In addition, the said right of assumption should be available to the RP and the RA. When the decision to assume is being exercised by the RP, the same should be subject to the approval of the committee of creditors. In addition, akin to the US regime, the said assumption should be subject to the approval of the court in order to ensure necessary checks and balances. Further, at the time of assumption, the RP or the RA should be required to: (i) cure all defaults other than pre-petition payment defaults; and (ii) assure the performance of prospective obligations. The counterparty would be paid in full for the performance of contract from the insolvency commencement date. Further, the RP or the RA should not be required to cure past defaults that are 'non-material' and 'impossible' to cure. For instance, debtor's failure to comply with certain covenants requiring it to provide certain information and certifications within a stipulated timeline, which has elapsed, may be deemed as 'non-material' and 'impossible' to cure.

The said position diverges from the US stance to the extent that it does not require pre-petition payment defaults to be cured and compensation to be provided for any past defaults. This stems from the fact that the pre-petition liability to the counterparty will constitute a claim against the CD during the CIRP and that in the event of liquidation of the CD, the counterparty would be entitled to the liquidation value of its unsecured claim. The US jurisdiction provides for the payment of all past defaults in priority as an administrative expense on the grounds of 'fairness' chiefly. However, it fails to take into account the countervailing principle of 'equality' of distribution amongst similarly placed creditors in the context of insolvency. It would be deemed to be unfair to other similarly situated creditors that a counterparty would be entitled to payment in full for its pre-petition claims merely on account of its contract being assumed. [161]

Akin to the US jurisdiction, the Indian insolvency regime should provide carve outs for the following executory contracts on the same policy reasons as discussed in Chapter II:

(a) executory contracts, where the party other than the debtor has been excused by the applicable law from accepting performance from or providing performance to an entity other than debtor and such party does not agree to the assumption or assignment of the contract;

(b) executory contracts in relation to providing loans or financial assistance to the debtor or in relation to the issuance of security instruments of the debtor.

Further, the treatment of government licenses providing for the right to use public property such as mines and spectrum, poses peculiar problems on account of the fact that these natural resources are held by the government for the public as *cestui que trust* and the right to use provided to the licensee does not create ownership or possession rights in favour of the licensee. In addition, these resources are governed by specialised, sector-specific statutes, and the treatment of such resources entails significant public policy and public interest considerations. While the National Company Law Appellate

Tribunal has held that the right to use spectrum is an intangible asset of the debtor and can be subject to insolvency proceedings,[162] the matter is currently *sub judice* before the Supreme Court.[163] Thus, the absence of a legislative framework has affected the insolvency resolution of thousands of crores of stressed assets causing significant delays resulting from protracted legislation.

Undue hardships to the counterparty

The mechanism for the assumption or rejection of contracts creates special equities by diverging from the settled contractual principles for the purposes of continuation of the debtor as a going concern and its effective resolution. However, at the same time, it is necessary to ensure that the creation of such special equities should not cause undue hardship to the counterparty and hamper its financial viability and ability to continue as a going concern. Therefore, it is proposed that the rejection or assumption of executory contract, as the case may be, should not be permitted if the counterparty is able to demonstrate to the court that the assumption or rejection of the executory contract, as the case may be, will cause undue hardship to it. The Supreme Court has generally interpreted the term 'undue hardship' to mean:

> under Indian conditions expression "undue hardship" is normally related to economic hardship. "Undue" which means something which is not merited by the conduct of the claimant, or is very much disproportionate to it. Undue hardship is caused when the hardship is not warranted by the circumstances. [164]

For instance, where a contract sought to be rejected by the RP, is vital for the continuation of the solvent party as a going concern, its rejection should not be permitted. Further, on assumption, the liabilities arising from performance during the CIRP will be treated as CIRP costs and be paid out during the distribution of proceeds. In most cases, as long as liabilities arising from the performance during the CIRP are treated as CIRP costs or are paid on an ongoing basis during the moratorium itself under the scope of section 14(2A) of the Code, no undue hardship should be deemed to be caused to the counterparty. However, in exceptional cases, when it may not be financially viable for the solvent counterparty to continue to supply at the existing rates without payment of past dues and renegotiation of existing rates, the assumption of such contract should not be permitted.

Scope of partial modification of obligations under contracts

The policy rationale for unilateral modifications of contracts by the RP or the RA, appears tenuous, as it impinges directly upon the principles of contractual sanctity and party autonomy, by compelling the counterparties to perform obligations on such terms that they may not be agreeable to. It also entails the moral hazard of a debtor strategically initiating voluntary insolvency proceedings with an intention to modify contractual terms and liabilities. It is further contrary to the principle of fairness and may drive up the cost of consideration of entering into contracts with companies having a weak financial positioning.

In addition, neither the US nor the UK permits partial assumption or rejection of obligations under contracts. Further, the UNCITRAL Legislative Guide on Insolvency Law prescribes that:

> Whatever rules are adopted with respect to continuing performance or rejection of contracts, it is desirable that any powers of the insolvency representative should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue performing certain parts of a contract and reject others.[165]

However, in the Indian context, it has been witnessed that the ability to implement a resolution plan has been hampered due to the failure of the RA to obtain requisite approvals from counterparties to essential contracts of the debtor owing to the operation of 'change in control' clauses.

In *Jaypee Kensington Boulevard Apartments Welfare Association & Others v. NBCC (India) Ltd. & Others,*[166] the Supreme Court held that a resolution plan cannot modify the terms of a contract and dispense with the requirement of seeking permission from the counterparty for any business transfer. The Supreme Court noted that:

> The stipulations/assumptions in the resolution plan, that approval by the Adjudicating Authority shall dispense with all the requirements of seeking consent from YEIDA for any business transfer are too far beyond the entitlement of the resolution applicant.

The Insolvency Law Committee Report dated February 2020 also recognised that the RA may require approvals of counterparties to the contracts that are essential for the continuation of the debtor. However, the Committee did not provide a finding on the said issue and noted that:

> The Committee was informed that there is also a lack of clarity regarding procurement of counter-party approvals for continuation of critical contracts on change of control, in cases where the counter-party is not a government authority. However, the Committee agreed that it may be prudent to allow practice in this regard to develop further, and agreed that it may not be necessary to make any recommendations in this regard at this stage.[167]

An absence of a legislative scheme in this regard may be detrimental to the effective resolution of the debtor, as the counterparties may unreasonably withhold the consent for change in control of debtor and affect value maximisation of the assets of the debtor. Therefore, in certain instances, the waiver of 'change in control' clauses in contracts that are central to the CIRP, may be vital, especially when the counterparty's consent is not forthcoming and the counterparty may be resorting to 'ransom payments'. Further, it is expected that the undue hardship rule would take care of the interests of the counterparties, by ensuring that the waiver of such 'change in control' clauses would not be permitted by the court when it causes any undue hardship to the counterparty. Such a safeguard effectively ensures that 'change in control' clauses do not derail the effective resolution of the company. At the same time, it ensures that certain contracts, where the identity of the persons in control is critical, are not modified without the consent of the counterparty.

Therefore, the Indian model should provide a limited carve-out for unilateral modification and waiver for 'change in control' clauses in respect of certain contracts that are central to the CIRP and where the waiver of such clause does not cause any hardship to the counterparty or affect the interests of the counterparty.

Timeline and ride through

It is proposed that the RP as well as the RA will have the powers to assume or reject executory contracts. Therefore, any assumption or rejection of executory contracts can take place prior to the confirmation of the resolution plan.

The need to exercise the power of assumption will arise only when the counterparty intends to terminate the contract and the said contract is central to the CIRP. In addition, the need to exercise the power of rejection will arise only when the contract is deemed to be onerous. Therefore, the contracts that are neither central to be explicitly assumed nor onerous to be explicitly rejected, will ride through the insolvency resolution process and be deemed to be assumed by the RP or the RA, as the case may be.

Given that the Liquidation Regulations also provide for the sale of the debtor on a going concern basis now and cast an implicit duty on the Liquidator to administer the debtor as a going concern,[168] it is proposed that the said mechanism for the assumption and rejection of contracts should also be provided to the Liquidator till the time the Liquidator attempts to sell the debtor as a going concern.

Effect of assumption and rejection of contracts

On the rejection of an executory contract, any pre-petition liability to the counterparty will be treated as per the distribution mechanism provided under section 53 of the Code. Similar to the position under the Liquidation Regulations, any compensation or damages payable on account of rejection should be deemed and treated as 'any remaining debts and dues' under section 53(1)(f) of the Code.
Further, it is proposed that the following mechanism should be adopted in relation to payment liabilities on account of the assumption of an executory contract:

(a) **Pre-CIRP performance:** Any liability or claim arising to the counterparty for any performance of a contract prior to the insolvency commencement date, should be treated as per the distribution mechanism provided under section 53 of the Code;

(b) **CIRP performance:** Any liability or claim arising to the counterparty for any performance of a contract during the CIRP should be treated as a CIRP cost under section 53(1)(a) of the Code and be paid in full.

Standard of proof

For the rejection of executory contracts that are onerous, the 'burdensome' test is aligned with the proposed model in the context of India. Therefore, for the rejection of an executory contract, it should be established that the performance of the contract will be unviable or unprofitable. Therefore, a contract cannot be merely rejected if an alternative arrangement is more profitable, and the higher threshold of the assumption of the contract resulting in a net loss, should be demonstrated.
For the assumption of executory contracts in the context of the proposed model, it would require a demonstration of the fact that the said contract is central to the successful resolution of the CD and the failure to assume such contract would result in the CD not being able to continue as a going concern. Therefore, under this test, a contract cannot be merely assumed if the assumption of a contract would be beneficial to the CD, and it should be established that the said contract is central to the CIRP.

Conceiving a model for treatment of clauses providing for termination or modification of executory contracts on an insolvency event

Ipso facto clauses

The Code is silent in relation to the validity of *ipso facto* clauses. The said legislative vacuum was highlighted by the Supreme Court in the case of *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta & Others.*[169] The Supreme had called for legislation on the matter by noting that:

> Consequently, we hold that question of the validity/invalidity of *ipso facto* clauses is one which the court ought not to resolve exhaustively in the present case. Rather, what we can do is appeal in earnest to the legislature to provide concrete guidance on this issue, since the lack of a legislative voice on the issue will lead to confusion and reduced commercial clarity.

Further, the Supreme Court, in this case, did not allow for the termination of the power purchase agreement solely on account of the initiation of the CIRP of the debtor, as this termination would have resulted in the debtor not being able to continue as going concern, as this contract was central to its revival. Similarly, in *TATA Consultancy Services Limited v. Vishal Ghisulal Jain, Resolution Professional, SK Wheels Private Limited,*[170] the Supreme Court reiterated that *'a party can be restrained from terminating the contract only if it is central to the success of the CIRP'.* The Supreme Court further held that there is no bar on termination of a contract on grounds unrelated to the insolvency of the debtor.

Thus, the Supreme Court has recognised the need to invalidate *ipso facto* clauses in contracts which are central to the CIRP, while leaving the broader question of general validity of *ipso facto* clauses to the legislature. In this regard, it is proposed that the Code should invalidate any clause providing for termination or modification of contracts on the occurrence or subsistence of any insolvency-related event. An *ipso facto* clause underlines the contractual assumption that a party that is subject to insolvency, will not be able to perform its obligations, and therefore, a right to terminate the contract should accrue. Such an underlying assumption of *ipso facto* clauses runs contrary to the fundamental policy of the Code to ensure the survival and resolution of the debtor as a going concern. Therefore, an *ipso facto* clause, on the face of it, appears to run contrary to the public policy of the Code and should be invalidated. In this regard, it may be noted that the UNCITRAL Legislative Guide on Insolvency Law also recommends invalidation of *ipso facto* clauses.[171] Thus, incorporating a broader anti-*ipso facto* rule aligns with the object of the Code to ensure the survival and revival of the debtor.

It is further proposed that akin to the Bankruptcy Code, the following exceptions should be carved out under the Indian regime as well:

(a) executory contracts, where the party other than the debtor has been excused by the applicable law from accepting performance from or providing performance to the RA or the RP or the assignee of such contract and such party does not agree to the assumption of the contract;

(b) executory contracts in relation to providing loans or financial assistance to the debtor or in relation to the issuance of security instruments of the debtor;

(c) complex financial market contracts such as securities contracts, commodities contracts, forward contracts, swaps arrangements, repurchase contracts and master netting contracts.

Further, given that the Liquidation Regulations also provide for the sale of the debtor on a going concern basis now and cast an implicit duty on the Liquidator to run the debtor as a going concern,[172] it is proposed that the invalidation of *ipso facto* clauses should also be extended in a liquidation setting till the time the Liquidator attempts to sell the debtor as a going concern. However, *ipso facto* clauses should be enforceable in a traditional liquidation, as the purpose of invalidation of *ipso facto* clauses is to enable the debtor to continue as a going concern. In a traditional liquidation, where the Liquidator attempts to only realise the assets of the debtor without requiring to administer the debtor as a going concern, such an interference with contractual rights may not be warranted. Even though the UK jurisdiction extends the invalidation of *ipso facto* clauses in a liquidation setting, the policy rationale has been questioned on the same grounds as discussed above.[173]

Right of termination by the solvent party on grounds other than insolvency

As noted by the Supreme Court, the invalidation of *ipso facto* clauses will not affect the termination of a contract on grounds unrelated to the insolvency of the debtor.[174] However, the exercise of the right of termination by the solvent party on grounds other than insolvency will affect the ability of the RP to assume contracts that may be central to the CIRP. Therefore, it becomes instrumental that the insolvency framework should limit the right of the counterparty to terminate contracts on grounds other than insolvency. Accordingly, it is proposed that in case the counterparty desires to terminate the contract on grounds other than insolvency, then it should send a prior notice of fifteen days to the RP. In case the RP after taking the approval of the committee of creditors, does not deem the contract to be central to the CIRP, it should permit the termination of the contract. However, in case the RP after taking the approval of the committee of creditors, deems the contract to be central to the CIRP, it should provide an intimation to the counterparty and make an application to the court within thirty days for the assumption of the contract. Further, when a notice for termination is sent to the debtor during the consideration of the resolution plan(s), the RA(s) should be allowed to modify its resolution plan by seeking appropriate reliefs under the resolution plan for assumption of such contract in case it is central to the CIRP, and the same would be subject to the approval of the NCLT.

Further, as discussed before, in case of assumption of a contract, the RP or the RA, as the case may be, should be required to: (i) cure all defaults other than pre-petition payment defaults; and (ii) assure the performance of prospective obligations.

Such an approach balances the contractual rights of the parties with the objectives of the Code to save the debtor as a going concern.

Anti-deprivation rule

Section 14 of the Code prohibits *'transferring, encumbering, alienating or disposing off by the corporate debtor any of its assets or any legal right or beneficial interest therein'.*[175] In essence, section 14 reflects the anti-deprivation rule by prohibiting any transfer or alienation of CD's assets or interests. However, in our opinion, the textual language of section 14 can be clarified to provide a prohibition on the transfer of any asset, legal right or beneficial interest of the debtor by any third party through the use of contractual devices, as section 14 presently only specifies a prohibition on any transfer of asset or interest by the CD.

CONCLUSION

It is undeniable that the financial viability of any company hinges on its ability to draw benefits from its contractual arrangements, and therefore, executory contracts constitute a critical asset of the debtor, having a direct bearing on the ability of the debtor to remain viable enterprise. As a result, any effective insolvency resolution mechanism should provide for the treatment of executory contracts with an aim to ensure the continuation of the debtor as a going concern and its efficient resolution.

Any mechanism for treatment of executory contracts would inherently be in conflict with the established principles of contract law, and this remains the primary concern in the introduction of any such mechanism. The equities sought to be created and objectives furthered under an insolvency regime providing for the treatment of executory contracts, would often be anomalous to the settled principles of sanctity of contract and party autonomy. However, such conflicts and anomalies ought to be resolved in favour of the objectives of the insolvency regime, which have wider socio-economic and public interest implications. Economic legislations often introduce certain incongruities in the law. However, as has been consistently held by courts in India, such incongruities are acceptable when weighed against the wider public interest that such legislations serve. [176]

The Code is an economic legislation having wide and far-reaching socio-economic consequences. It is not a mere tool for recovery of debts for the creditors. When viewed from this perspective, an insolvency legislation providing for re-adjustments of equities in relation to contractual rights with necessary checks and balances, furthers the public interest involved in the resolution of debtors, and such public interest outweighs any considerations pertaining to individual contractual rights.

This paper, therefore, seeks to conceptualise a legislative model for the treatment of executory contracts in the Indian context, in order to highlight and initiate discussion on the issue.

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[28] Supra Note 15, p. 1448.
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[92] Supra Note 45; Supra Note 85, p. 204.
[93] Supra Note 45.
[94] Rule 4.218, The Insolvency Rules, 1986; Supra Note 55, p. 228.
[95] Supra Note 45.
[96] *Ibid.*
[97] Supra Note 55, pp. 1-2.
[98] Supra Note 1
[99] Supra Note 9, para. 116.
[100] Supra Note 55, pp. 1-2.
[101] For example, US, France, Greece, Denmark, Germany, UAE, Canada, Australia, Austria, Spain have expressly invalidated or restricted *ipso facto* clauses; Supra note 44, p. 16.
[102] For example, India, China, Lithuania, Turkey have not expressly legislated on *ipso facto* clauses; Supra Note 1; Supra Note 44, pp. 14-15.
[103] Supra Note 44, pp. 12-16.
[104] Supra Note 85, p. 217.
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[106] Section 365(e), Chapter 11, The U.S. Code.
[107] Supra note 19.
[108] Section 365(e)(2)(A), Chapter 11, The U.S. Code.
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[129] *Lomas v. JFB Firth Rixson*, 2010 EWHC 3372 (94). Here, the England and Wales High Court noted that even though the anti-deprivation rule is a vital public policy principle, the jurisprudence regarding the same has been 'disfigured' owing to its propensity for 'formalistic distinctions'.
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[149] Supra Note 21, p. 113.
[150] *Ibid.* p. 115.
[151] Supra Note 141
[152] *Ibid.*
[153] *Ibid.*
[154] Section 4, The Specific Relief (Amendment) Act, 2018.
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[165] Supra Note 9, para 126.
[166] (2022) 1 SCC 401.
[167] Supra Note 159.
[168] Regulation 32A, Liquidation Regulations.
[169] Supra Note 1.
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[175] Supra Note 156.
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[177] *Swiss Ribbons (P) Ltd. v. Union of India*, (2019) 4 SCC 17.

7

LITIGATE OR MEDIATE?

LESSONS FROM U.S. BANKRUPTCY MEDIATIONS

— *Laura N. Coordes*

Executive Summary

In the United States, mediation often plays a central role in a bankruptcy process. By contrast, mediation has yet to be formally used in insolvency cases in India. As India considers whether and how to accommodate the use of mediation in insolvency cases, it can look to the US experience to get a sense of the benefits and pitfalls that can come with using mediation in the insolvency context. To aid this endeavor, this article evaluates mediation in a variety of U.S. bankruptcy disputes. It illustrates the issues that have arisen with respect to incorporating mediation into U.S. bankruptcy cases, including the growth of virtual mediations spurred by the COVID-19 pandemic.

Keywords: Mediation, Insolvency, Litigation, Disputes, Virtual mediation

INTRODUCTION

In the United States, mediation often plays a central role in a bankruptcy process. Some courts even have formal mediation programs that can be used to work out particular problems in a bankruptcy case, such as a mortgage modification in a Chapter 13 individual bankruptcy case.[1] In large bankruptcy cases in particular, it is not uncommon for a judge to appoint one or more mediators to help the parties work out a mutually agreeable solution or settlement.[2] Scholars, both foreign and domestic, have written in praise of mediation's benefits in the bankruptcy and insolvency context.[3]

Yet, mediation is not a panacea. Because mediation is a private, out-of-court process, it lacks transparency and may selectively exclude parties from a seat at the negotiating table. This dynamic has perhaps become most pronounced in mass tort bankruptcy cases in the United States, where parties publicly accuse others of leaving them out in the cold while deals are made and key information is exchanged.[4] Similarly, some tort victims may prefer to litigate their claims in order to have their 'day in court.'[5] Thus, as developed as the U.S. bankruptcy mediation process already is, it is not a perfect system, and questions remain about the proper form and function of private mediations in otherwise public bankruptcy cases. In other words, mediation's place in the U.S. bankruptcy system is still very much a work in progress.

In India, the situation is quite different. Although mediation has been used in India, it has yet to be used as a resolution mechanism in insolvency cases.[6] However, that may change, as the Insolvency and Bankruptcy Board of India has recognised that mediation may be an important and useful tool.[7] As India considers whether and how to incorporate formal legal modifications or other changes to accommodate the use of mediation in insolvency cases, it can look to the experience of the U.S. to get a sense of the benefits and pitfalls that can come with using mediation as a dispute resolution tool in the insolvency context.

To aid this endeavor, this article evaluates the strengths and weaknesses of mediation in a variety of U.S. bankruptcy disputes, from individual cases to large corporate restructurings. Using case studies, it illustrates how mediation works in various types of bankruptcy cases, as well as the issues that have arisen with respect to incorporating mediation into U.S. bankruptcy cases, and the recent growth of online and virtual mediations spurred by the COVID-19 pandemic.[8]

It does so with the aim of explaining how the U.S.'s experience with bankruptcy mediation illustrates both successes and failures with incorporating mediation into the insolvency context. The article extrapolates core values and principles that India might consider as it determines whether and how to formally incorporate mediation into its own insolvency framework. Mediation is undoubtedly a useful tool in nearly every litigious context, but this article seeks to identify key aspects that both the U.S. and India can consider as they seek to develop the role of mediation in insolvency and bankruptcy proceedings. In doing so, the article also sheds light on the way legal mechanisms can affect who is included and who is excluded in a legal process. Any proposals for reform must be cognizant of the role private mechanisms, such as mediation, play in an otherwise public process.

The article first describes how mediation works in U.S. bankruptcy cases, while also discussing scholarly praise and criticism of mediation. It goes on to examine current uses of mediation in India and offers some thoughts on why mediation may be useful in the insolvency context. It then embarks on several case studies to show how mediation works in a variety of U.S. bankruptcy cases. At the end, it articulates lessons for both India and the U.S., as both countries consider increased use of mediation in their legal systems.

BANKRUPTCY MEDIATION IN THE U.S.

In the U.S., alternative dispute resolution (ADR), and in particular mediation, has become a popular method of resolving bankruptcy disputes.[9] In 1998, the U.S. Congress passed the Alternative Dispute Resolution Act, which gave all U.S. district courts the authority to create and implement ADR programs.[10] Approximately 10 years later, by 2009, over half of the bankruptcy courts in the U.S. had explicitly authorised mediation, either by local rule or order.[11] In addition, approximately 40 bankruptcy courts had adopted local rules or orders that allowed them to order parties into mediation.[12] Thus, within a relatively short time, mediation became an accepted practice in the bankruptcy process.

At the same time, there is substantial variation among U.S. courts as to how and when they permit mediation. As of 2019, 76 out of 94 districts had some type of local mediation rule, leaving 18 districts without a rule.[13] Some courts mandate mediation for disputes, while in others mediation is optional.[14] Additionally, some courts have established procedures for the timing of mediation in relation to discovery and other litigation within the bankruptcy context.[15]

Mediation has been used for all sorts of bankruptcy disputes, including cash-collateral/DIP financing disputes, plan objections, preferences, fraudulent transfers, objections to discharge, lien priority/avoidance, real estate title contests, equitable subordination, and collection/turnover actions.[16] Several bankruptcy courts have also established a mortgage modification mediation program for individual bankruptcies, which allows the debtor and their mortgage lender to potentially reach an agreement on modifying the debtor's mortgage.[17] In general, in both business and individual cases, mediation is primarily used for adversary proceedings, which are disputes within the main bankruptcy case.[18] In recent years, many bankruptcy judges have taken a more proactive approach to mediation and may suggest mediation early on in a case, even if the parties do not ultimately mediate until much later.[19]

In bankruptcy mediation, as in mediation in other contexts, the mediator does not decide the dispute but instead facilitates a resolution that both parties can accept.[20] Although the mediation process may vary depending on the specific context in which it is used, in general, mediation occurs in three stages. First, the mediator organises a general session, which all parties, and their counsel, attend.[21] Next, the mediator holds private caucuses with each side of the dispute.[22] Finally, there is a closing session, where ideally an agreement between both sides is reached.[23]

Parties seek out mediation and other forms of ADR because these mechanisms are almost always cheaper than the alternative: litigation of the dispute in bankruptcy court.[24] Even if the mediation does not end in an agreement, the process itself and the preparations necessary to engage in it can help the parties prepare for trial.[25]

In sum, mediation has been a part of the U.S. bankruptcy system, in one form or another, for several decades. Mediation is used in a wide variety of contexts within bankruptcy, and the process may vary from court to court. In general, mediation appears to be viewed favorably within the U.S. by practitioners and judges.

BENEFITS AND DRAWBACKS OF MEDIATION

Because mediation and other forms of ADR have been in use in U.S. bankruptcy cases for some time, scholars and commentators have had the chance to study how the process works and to identify both efficiencies and impracticalities. This part discusses some general observations about mediation's benefits and drawbacks in the bankruptcy process.

Mediation has numerous benefits. It gives disputing parties time to take a hard look at their positions and to evaluate the strengths and weaknesses of their case.[26] The presence of a neutral party (the mediator) encourages both sides to share information about their positions while lessening personal feelings that could impede the settlement process.[27] Mediation also allows parties to avoid the expense and uncertainty of a trial, giving them instead a chance to exercise more control over how the dispute is resolved.[28] Indeed, a critical benefit of mediation is that, unlike in litigation where a judge decides the outcome, in mediation the parties can 'shape their own agreement.'[29]

Of course, mediation comes with challenges as well as benefits. Because there is no federally standardised mediation process in the U.S., practitioners must be aware of any local rules governing mediation and ensure that they follow those rules. In addition, maintaining confidentiality in mediation is a must.[30] The mediator should not be required to testify, in court or otherwise, about the substance of the mediation.[31] There is no uniform federal mediation privilege; however, 38 bankruptcy courts address confidentiality in mediation via local rule or order.[32] Mediators may also create their own agreements and ask the parties to sign them as a condition of proceeding with the mediation.[33] Thus, although confidentiality is paramount in mediation, the specific rules and practices governing confidentiality in the mediation process may vary from court to court or even from mediation to mediation.

As a private process within an otherwise public proceeding, bankruptcy mediation can pose some challenges. The bankruptcy judge, who oversees the main bankruptcy case, is not a party to mediation proceedings.[34] The need to maintain confidentiality in mediation can conflict with the judge's desire to know more about what took place in mediation so that the judge can better oversee the case.[35] These conflicts can occasionally boil over.[36] For example, the mediator in the bankruptcy of *In re Caesars Entertainment Operating Company* ultimately resigned and filed a letter with the court expressing his frustration with the bankruptcy judge, who had suggested that the mediator should testify in court about the mediation's progress.[37] The mediator pointed out that the mediation should be confidential and claimed that the court 'either misspoke or doesn't understand how such disclosures would be viewed by participants and the markets.'[38]

As bankruptcy has become an increasingly popular forum for resolving mass tort litigation, mediation has played a role in mass tort bankruptcy cases as well.[39] These bankruptcies often contain multiple types of creditors and many disputes about the payment of claims. The bankruptcy of Eagle-Picher provides an example of the benefits and drawbacks of mediation in the mass tort context. Eagle-Picher filed for bankruptcy in 1991 after failing to reach a global settlement with respect to current and future asbestos claims against it.[40] The parties first attempted negotiations on their own; however, after two months, the bankruptcy judge appointed Jerry Lawson, a mediator based in Cincinnati, Ohio, to help the parties reach a consensual plan of reorganisation.[41]

The mediation process took a total of 17 months and succeeded in reaching an agreement on the main principles of a reorganisation plan.[42] However, the process was not without its difficulties. For example, the mediator began to work almost exclusively with the debtor, the injury claimants' committee, and the future claims representative, while leaving other constituents in the case, namely the unsecured creditors' committee and the equity committee, largely out of the process.[43] In June of 1993, approximately a year after mediation had begun, the creditors' committee and equity committee moved to modify or terminate the mediation or, alternatively, to lift the communications ban imposed on the mediator so that the mediator could speak to the committees about the substance of the negotiations with the other parties.[44] The committees expressed concern that they would be 'ambushed' with a 'take-it-or-leave-it plan,' because they had no access to any information about progress made in the mediation.[45] Although the bankruptcy court eventually denied the committees' motions, the mediator did allow counsel for the committees to speak with attorneys involved in the mediation.[46] Unfortunately, however, both committees remained sidelined from the main mediation efforts.[47] The Eagle-Picher case shows that although mediation may result in a successful resolution, it may do so only by excluding some parties or keeping their interests sidelined.

Although mediation is often touted as cheaper than litigation, it is not free. The parties typically pay the mediator in addition to their own attorneys.[48] In a 2015 decision from the Bankruptcy Court for the Southern District of Texas, the court suggested that parties can minimise the cost of mediation by electing to pursue it only after they attempt to reach a settlement without a mediator's involvement.[49]

Even if mediation is cheaper than a trial, there are some reasons for parties to prefer a trial over ADR. First, parties may want to have their 'day in court': a public airing of their grievances, and a public decision by a judge, hopefully in their favor.[50] Having a trial or other public hearing may also deter unwanted behavior. The bankruptcy court in *In re Smith* discussed the *'importance of having a hearing (or trial) so that one party will win and the other will lose. The losing party…may stop behaving in the manner that created the dispute in the first place.'*[51] A mediation, which takes place in private, may not have a similar deterrent effect.

The identify and qualifications of the mediator may have as much of an impact on the mediation's outcome as other factors. Courts in different states have different requirements for who can be a mediator.[52] For example, some courts allow judges or former judges to serve as mediators, while other courts believe this to be inappropriate.[53] Having a judge as a mediator may provide cost savings, as current judges that serve as mediators receive only reimbursement for their expenses rather than a mediation fee.[54]

It is also important for the parties to realise that mediation takes preparation.[55] For example, parties must submit mediation statements to the mediator in advance of the mediation.[56] These statements, in turn, help the mediator prepare by providing the mediator with the relevant background and the positions of the parties.[57]

Indeed, as mediators themselves have pointed out, mediation technically begins even before the start of the formal proceedings, because all parties must prepare for those proceedings.[58] In addition, mediators, though neutral, perform an educative and evaluative role in order to help parties reach an agreement.[59] The mediator does not choose a 'winner' or a 'loser,' but rather evaluates the case from a neutral standpoint and informs the parties of the strengths and weaknesses of their positions.[60]

Although not all mediations end in settlement, a failed mediation may still have provided some benefits. For example, the parties may be closer to reaching a settlement after having engaged in mediation, even if they do not settle at the end of the mediation session.[61] Mediations also save all parties and the court time and money by reducing or narrowing the scope of the issues that must be addressed at trial.[62] Finally, the process of preparing for mediation is helpful for preparing for trial as well.[63]

Like any process, mediation comes with costs and benefits, many of which can be observed by studying how the process has played out over the years in U.S. bankruptcy cases. The next part discusses how mediation has been used to date in India.

MEDIATION IN INDIA

In India, mediation has become a popular form of ADR, and even a 'first option' for disputing parties.[64] A 2002 amendment to the Code of Civil Procedure allowed courts to refer certain matters to out-of-court settlement procedures, including mediation.[65] Additionally, in *Salem Bar Association v. Union of India*, the Supreme Court of India expressed support for mediation and directed that a committee be appointed to design model rules for mediation procedures.[66] Following that ruling, the Law Commission of India produced a paper on Alternative Dispute Redressal and Mediation Rules, which was used by several of India's High Courts.[67] To further encourage mediation, courts in several cities have even annexed mediation centers within the court complexes.[68]

With respect to businesses, India's Companies Act provides for the institution of a mediation panel, which parties or the court can use during proceedings.[69] The Commercial Courts Act also provides that parties must first mediate prior to initiating a suit, unless urgent interim relief is necessary.[70] However, India does not have a national mediation law, and much like in the U.S., mediation proceedings are not uniform from one court to the next.[71]

Although mediation has been used as an alternative to other forms of litigation, it has not yet become a part of India's insolvency processes. There are several potential benefits to adding a mediation component or option in the specific context of insolvency.

First, India's Insolvency and Bankruptcy Code, 2016 (IBC) is still relatively new; however, observers have noted that the processes provided under the IBC are often 'delayed by excessive litigation.'[72] In particular, under the IBC, the corporate insolvency resolution process (CIRP) was initially supposed to be completed in 270 days or fewer.[73] In practice, many CIRPs have taken much longer, often due to litigation and stakeholder conflict.[74] Mediation may speed up the process and ensure that the views of more stakeholders are taken into account.[75] For example, under the IBC, operational creditors, such as trade creditors and employees, do not hold voting rights, in contrast to financial creditors.[76] Thus, a mediation process could be particularly useful if it allows operational creditors to participate.

In addition to delays caused by litigation, the courts that preside over insolvency proceedings, the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT), have a significant caseload.[77] Thus, it may take some time for these tribunals to get through their dockets. As an out-of-court alternative, a successful mediation can take matters off of court dockets, and creditors and other stakeholders will have the option to pursue an out-of-court process as an alternative to a formal insolvency procedure.

Recent developments make it likely that CIRPs will take even longer in future. The Insolvency and Bankruptcy Code (Amendment) Act 2019 extended the time limit for a CIRP to 330 days.[78] However, in *Essar Steel v. Satish Kumar Gupta*, the Supreme Court of India declared that this time limit was advisory rather than mandatory.[79] Given the length of time CIRPs are likely to drag on in light of litigation, court overload, and merely suggested time limitations, mediation or, indeed, any other ADR process that can be used in conjunction with the proceedings may help parties to reach conclusions faster and to make progress in resolving disputes without the need to be in court.

While in the U.S., the bankruptcy process is not generally viewed as litigation-friendly,[80] in India, certain features of the insolvency process may make it more susceptible to litigation. For example, under the IBC, financial creditors exercise significant power, essentially determining the outcome for all stakeholders in the CIRP.[81] If other stakeholders wish to voice concerns or objections, they must engage in litigation.[82] Mediation could provide an alternative mechanism for stakeholder voices to be heard if introduced into the CIRP.[83]

Notably, India already has the necessary legal infrastructure to incorporate mediation into insolvency procedures.[84] As mentioned previously, the Civil Procedure Code allows courts to refer disputes to ADR, and the Companies Act 2013 provides for the referral of some cases to an expert mediation panel.[85] At the same time, India needs institutional capacity in the form of qualified, experienced mediators to ensure that mediation is successfully incorporated into insolvency proceedings.[86]

In short, India appears well-positioned to incorporate mediation into its insolvency process, and mediation may hold some particular benefits in the Indian context. To further illustrate some aspects of mediation that lawmakers may wish to consider, the next part provides several case studies of mediation in recent U.S. bankruptcy proceedings.

CASE STUDIES

As discussed above, mediation has long been used in U.S. bankruptcy proceedings. This part focuses on a variety of cases in which mediation has been used to illustrate the breadth and depth of mediation's potential, as well as some strengths and weaknesses of various mediation procedures.

In re The Archdiocese of Saint Paul and Minneapolis

The Archdiocese of Saint Paul and Minneapolis (Minnesota) is an example of a mass tort bankruptcy where mediation was used to address numerous competing claims and interests. The Archdiocese filed for Chapter 11 bankruptcy on January 16, 2015, seeking to reorganise and address operating deficits and litigation brought by survivors of alleged sexual abuse by clergy within the diocese.[87] Approximately three and a half years later, on June 28, 2018, the diocese filed its plan of reorganisation, and on September 25, 2018, the U.S. Bankruptcy Court for the District of Minnesota approved the plan, paving the way for the archdiocese to exit from bankruptcy.[88]

Mediation played a major role in the bankruptcy process. Just days after the archdiocese filed the case, the bankruptcy judge ordered the parties to mediate.[89] Specifically, the judge ordered that the archdiocese, its insurers, and its creditors, including sexual abuse victims, begin mediation with former magistrate judge Arthur Boylan.[90] Boylan was an experienced mediator, having previously successfully led National Football League (NFL) players to end a lockout several years earlier.[91]

Mediation appeared to be a smart strategy because many victims (and their counsel) were unhappy with the archdiocese's bankruptcy filing. Some accused the archdiocese of using bankruptcy to avoid a public trial and specifically as a way to keep information about abuses and their cover-ups out of the public eye.[92] For its part, the archdiocese responded that bankruptcy would allow the church to equitably and collectively address all of the victims' claims.[93]

Despite the apparent unhappiness about the bankruptcy filing, victims' attorneys seemed open to the idea of mediation. As an attorney for many of the victims commented, '*We are delighted we have the opportunity to get to the negotiation table early before huge attorney's fees deplete the archdiocese's assets and there will be ample funds for survivors with full participation from the archdiocese and the insurance companies involved.*'[94] He praised the bankruptcy judge's mediation order as creating 'the opportunity to ensure a fair and speedy resolution of all current and future claims.'[95]

Early reports suggested that the parties viewed mediation as 'the opportunity for [a] peace treaty.'[96] Although parties must compromise in mediation, they gain the ability to exert some control over the outcome of the dispute.[97] Furthermore, diocesan bankruptcies were no stranger to the mediation process.[98] Indeed, the Archdiocese of Milwaukee (Wisconsin) and the Diocese of Helena (Montana) had both used mediation as part of their bankruptcy processes, with mixed success.[99]

In the case of the Archdiocese of Saint Paul and Minneapolis, the mediator, Judge Boylan, had substantial experience. Boylan had settled 'thousands of cases' through mediation, including the previously mentioned NFL lockout, which took 26 sessions and more than 100 days to resolve.[100] He therefore had experience addressing difficult issues and managing delicate interpersonal situations.[101]

The mediation in the Archdiocese's case took years but ultimately resulted in a consensual plan and the largest settlement reached to date in a bankruptcy case involving clergy sexual abuse.[102] The process was not without its ups and downs, however. Initially, two competing plans were filed with the bankruptcy court, and creditors were divided in their support for the plans.[103] Most abuse claimants voted for the plan put forward by the unsecured creditors' committee, while most other claimants voted for the plan put forward by the archdiocese.[104] Rather than approving one plan or the other, the bankruptcy judge denied both plans and again ordered the parties into mediation so that a consensual plan might be achieved.[105] After over 18 full days of in-person mediation, the parties finally reached agreement on a consensual plan.[106]

The bankruptcy of the Minnesota illustrates several important points about mediation. First, having an experienced mediator matters and is likely essential to getting the parties to participate in the mediation process. Second, ideally mediations will be inclusive—if consensus is desired, it is important that no party feels marginalised or left out of discussions. And third, even if mediation fails to produce the desired outcome on the first try, that does not mean that consensus is impossible. Indeed, the bankruptcy judge's willingness to send the parties back to mediation after two competing plans were presented to him was likely critical to the eventual, consensual outcome of the case.

In re Detroit, Michigan

Although mediation is often used in corporate bankruptcy proceedings to give parties the opportunity to reach a consensual plan of reorganisation or to resolve disputes about claims, mediations are used in other types of bankruptcies as well. The bankruptcy of the city of Detroit, Michigan provides a striking example of the importance of mediation in a Chapter 9 (municipal) bankruptcy case.

When the city of Detroit filed for bankruptcy in July of 2013, it was the largest municipal bankruptcy the U.S. had yet seen.[107] The bankruptcy judge presiding over the case immediately recognised the benefits of mediation and deployed a team of mediators to address various aspects of the case. Detroit reached a number of settlements with key creditor groups using mediation, including the so-called Grand Bargain, in which the State of Michigan and several philanthropic organisations worked with the city to help it pay down its debt while preserving a key asset, art owned by the Detroit Institute of Arts.[108] The city also brokered a 'miraculous' pension settlement through mediation.[109] 'Through court-ordered mediation, the City achieved settlement with every creditor group that was represented by counsel.'[110]

Detroit's mediations were successful in part because they had the full support of the bankruptcy judge overseeing the case. When Judge Rhodes, the bankruptcy judge, ordered the mediations, he gave significant and expansive authority to the mediation team.[111] Using this expansive authority, the mediation team was able to take many issues off the litigation docket, which arguably made it easier for Detroit to confirm its plan of debt adjustment.[112] Detroit's experience with mediation thus shows that the appointing judge's support for mediation may be key to the ultimate outcome of the process.

At the same time, Detroit's mediation raised some concerns that may be unique to the case of a bankruptcy proceeding involving a division of government. When the bankruptcy judge made the mediation appointment, he conveyed 'significant authority' to the mediation team in a case involving a city usually run by democratically elected officials.[113] In addition, the bankruptcy judge's overwhelming support for the Grand Bargain and other compromises reached in mediation may have convinced some of the city's creditors that it would be worthless to protest the plan, even if they felt that their rights were not adequately protected.[114]

Thus, the city of Detroit's experience with mediation shows that a judge's full-throated support of mediation may be a double-edged sword. On the one hand, such support may be critical or even necessary to producing an efficient outcome that parties can live with. On the other, when the judge throws his weight so forcefully behind mediation, it may signal to parties that it is useless to try to speak in opposition of the compromise being proposed. Although the judge in Detroit's bankruptcy did an admirable job in making sure that many voices were heard, both in mediation and in court proceedings,[115] judges must keep in mind that advocating too forcefully for mediation could have a stifling effect on voices that deserve to be heard.

In re Boy Scouts* of America and *Delaware BSA, LLC

The Boy Scouts of America (BSA), a youth scouting organisation based in the U.S., filed for Chapter 11 (reorganisation) bankruptcy in February of 2020 to deal with mounting child sexual abuse allegations and declining membership.[116] A few months after the filing, the bankruptcy judge overseeing the case appointed a three-member mediation panel to try to resolve disputes within the bankruptcy case.[117] Since that time, mediation has proceeded in the case, but the mediation process has hit several stumbling blocks. The case is currently ongoing and provides some cautionary lessons about the potential pitfalls of mediation.

Notably, in late 2021, one of the mediators on the panel resigned due to 'philosophical differences that have existed for some time with other parties that can no longer be reconciled.'[118] Just three weeks later, the bankruptcy judge removed another mediator from the panel after BSA named that mediator to be a 'special reviewer,' who would assist in overseeing a fund BSA had proposed to compensate victims of child sexual abuse.[119] The judge removed the mediator after determining that he had a 'stake in the outcome of the mediation' and that 'there is a reason to question his impartiality.'[120] The mediator's removal left only one of the three original mediators who had been appointed by the judge on the panel, and the judge remarked that she had considered terminating the entire mediation process.[121] Thus, BSA's experience with bankruptcy mediators highlights once again the importance of choosing a good mediator, one who will be neutral and who will be able to work with the parties without becoming bogged down in their disagreements.

As previously discussed, confidentiality is a key factor in mediations. The lack of a federal, uniform confidentiality standard has posed some problems in BSA's bankruptcy, as the parties in the case have engaged in a dispute about whether communications made in mediation should be protected from discovery.[122] As BSA's case involves extensive mediation, the bankruptcy judge could not find adequate precedent over whether certain mediation communications and documents were indeed privileged.[123]

The judge observed that, '*Even among big bankruptcy mediation this one may be unusual in its length and its breadth.*'[124]

Specifically, BSA has asked the bankruptcy judge to hold that minutes of the BSA's governing board's meetings discussing mediation proceedings, along with settlement discussions between mediating parties and settlement proposal drafts, are privileged and should not be produced as part of discovery.[125] BSA has argued that because mediation is ongoing, allowing discovery of these materials would chill talks and jeopardise the possibility of reaching further settlements.[126] Attorneys for BSA's insurers, which are seeking production of these documents, claim that the tradeoffs made in mediation 'go to some core arguments' and therefore must be made available in discovery.[127] Even BSA itself was seeking to allow some information to be made public, as it wished to admit the names of the mediators and the length of the mediation proceedings as evidence that the organisation's plan of reorganisation was the product of good faith negotiations.[128] Yet, the bankruptcy judge has no clear answer as to whether and what type of mediation privilege might be appropriate for mediations such as those ongoing in the BSA case, when those mediations have produced much of the forward movement in the case.[129] Indeed, BSA has always maintained that reaching a mediated deal is critical to ensuring the future of the organisation.[130]

The BSA bankruptcy also illustrates a potential pitfall when it comes to virtual mediations. In March of 2021, BSA sought to host claims mediation sessions in-person in Miami, Florida.[131] Several sexual abuse claimants objected to this proposal, seeking instead to have the mediations conducted virtually due to concerns about COVID-19.[132] The claimants argued that allowing BSA to negotiate a settlement in person would be unfair to those who could not attend in person due to health concerns.[133] The judge ultimately held that BSA could hold the mediation sessions in person, with a virtual component, in spite of the claimants' request to hold the negotiations exclusively in a virtual format.[134] Nevertheless, the claimants' argument that they would be unfairly prejudiced by appearing remotely while others attended in person raises questions about whether a hybrid mediation process will be fair to all parties involved.

The BSA bankruptcy is a treasure trove of potential traps for the unwary in the mediation process. Ensuring a qualified, neutral mediator; establishing clarity over the limits of confidentiality in the mediation process; and setting up procedures to help all participants in a hybrid mediation to feel that they are on equal footing are all considerations that should be undertaken when making mediation a central component of a bankruptcy process.

In re Roman Catholic Church* of the *Archdiocese of Santa Fe

The Archdiocese of Santa Fe (New Mexico) filed for Chapter 11 (reorganisation) bankruptcy in 2018 due to numerous sexual assault lawsuits and ongoing investigations against several of its priests.[135] The case is an example of a bankruptcy proceeding that has yet to reach a conclusion despite the extensive involvement of mediators. In this case, the mediation has yet to produce results after several years, and it is possible that the parties will have to resort to litigating their disputes instead.

In early 2022, after a third mediator began work on the three-year-old case, one victim's attorney expressed frustration that 'mediation hasn't gotten the job done before in this case.'[136] The new mediator, Paul J. Van Osselaer, has extensive mediation experience, including the successfully mediated settlement in the bankruptcy of U.S.A. Gymnastics, another organisation plagued by sexual abuse claims.[137] However, Van Osselaer's involvement came with a price tag of $700 an hour, and the second mediator in the case, Alan Malott, was still retained as a mediator.[138]

The Archdiocese's bankruptcy illustrates that mediation can take time and be expensive as well. The efforts of the parties have 'plodded along for three years with no end visible.'[139] A spokesman for the archdiocese remarked that although the archdiocese was negotiating with insurers, *'there's no way to speed it up.'*[140] In short, mediation appears to be costing money while providing few visible benefits to the parties. As the case is ongoing, it remains to be seen whether the mediation team will be successful in reaching a settlement that allows for victim compensation and other creditor payments.

Mortgage Modification Mediation

Bankruptcy mediation is not just for businesses (and municipalities). As a final example of mediation in action, consider mortgage modification mediations in Chapter 13 (individual) bankruptcies. A mortgage is often an individual, consumer debtor's biggest liability.[141] Consequently, reaching an agreement as to how to modify a mortgage so that the debtor may retain their home can be a significant step in a Chapter 13 bankruptcy.

To facilitate this process, several bankruptcy courts have instituted mortgage modification mediation (MMM) programs.[142] Through these court-implemented programs, debtors and their lenders can mediate to attempt a loan modification.[143] Either debtor or creditor can initiate the process, which is designed as an alternative to mortgage modification under the lender's procedures or other, out-of-court processes.[144]

Like other mediations, MMM proceedings are confidential, and the process may vary from court to court.[145] However, the basic process is as follows. Either the debtor or its lender can petition the court to begin the process.[146] Courts typically require debtors to dedicate a percentage of either their income or their current monthly mortgage payment to the modified mortgage.[147] Once the court approves the motion for modification, each party pays the mediation fees and agrees on how to divide up any additional costs.[148] If a modification agreement is reached after good faith negotiations, the court will approve the agreement.[149]

MMM programs are designed to be more streamlined and transparent than other loan modification programs.[150] At the same time, these programs are voluntary, and their success depends on the cooperation and buy-in from all participating parties and the bankruptcy court.[151] In addition, because there is no statutory authority for MMMs, courts that implement the programs face a risk that any procedures they use could be challenged by an unhappy lender.[152] Thus, MMMs illustrate both the potential for increased use of mediation in consumer bankruptcy cases[153] and the perils of a completely voluntary proceeding unsanctioned by statute.

CONCLUSION: LESSONS FOR INDIA AND THE UNITED STATES

The cases discussed above illustrate the extent to which mediation is a component of a variety of U.S. bankruptcy proceedings. At the same time, they also provide lessons for the U.S. about how to improve its proceedings, and they may be of assistance for India as its lawmakers consider whether and how to implement mediation into the insolvency process. Of course, when seeking to apply insights learned from one country's experience to the laws of another, attention must be paid to the differences in those countries' legal systems and cultural backgrounds. Although India's insolvency system is in many ways different from that of the U.S., in many instances, the lessons that can be learned from mediation in U.S. bankruptcy proceedings are likely broadly applicable. This article seeks to point out some possible considerations for both countries to explore as they seek to further develop mediation's role in their legal systems. Some of these considerations are highlighted below.

First, the party (or parties) recommending mediation and appointing the mediator may play a key role in the mediation's ultimate success or failure, even if this party does not play a direct role in the mediation process itself. In the U.S., it is frequently the judge who decides to send the parties to mediation in the first place, and the judge may also decide whether to require the parties to continue mediating or to give up after an initial attempt at mediation fails. Sometimes, the judge will even choose the mediator.[154] A judge's vocal support for mediation may inspire the parties to reach a consensus, or it may place undue pressure on parties who may simply want their day in court. When mediation is ordered by the judge or other authority, it might even seem like the judge is putting a thumb on the scale in favor of a mediated resolution, regardless of the merits of that resolution.

Second, a mediator with experience is undoubtedly desirable—however, what qualifies as 'experience' must be considered as well. Mediators should not be (or become) personally entangled in a case. Additionally, mediators must leave their egos at the door and be prepared to face a variety of possibly conflicting personalities. In the U.S., depending on the parties involved in mediation, a mediator may need to seek bankruptcy court approval for compensation, as well as for the final agreement that the parties reach.[155] For this reason, mediators should also be knowledgeable about the bankruptcy process and the court they are engaged in.[156] With respect to India, lawmakers may wish to consider whether and when formal court approval need be given to agreements reached in mediation.

Third, while most commentators agree that mediation is a money-saver, the cases discussed above show that it is not guaranteed to be quick, easy, or even all that cheap. Most mediators come with a price tag, and experienced mediators may demand even higher rates. Even if a mediation is resolved in a relatively short period of time, it may take up full days of the parties' time while it is ongoing. It may also be difficult for a judge to assess the progress of a mediation to decide whether to continue mediation talks, because mediations are private.

Fourth, relatedly, mediation is a highly private and confidential process, and confidentiality comes with its own pros and cons.[157] On the one hand, the privacy of mediation can encourage the parties to be candid and to express weaknesses or otherwise make concessions they might not be willing to make if they had to do so in a public setting.[158] On the other hand, as a private process, mediation risks leaving the judge and other parties feeling excluded to the extent they are not involved in the process. Further, because there is no uniform confidentiality rule in the United States, judges have expressed some confusion over what information from a mediation may be admissible in discovery or a public setting. It is important for all parties to know upfront what can be shared about mediation proceedings and what must be kept private.

Fifth, mediation is not designed to produce a win-win solution so much as it produces a resolution that all parties can live with. For this reason, although mediation does not always work out, it is almost always worth a try. At the same time, parties must be aware that they may not (and likely will not) walk away from the mediation feeling as though they have 'won.'

Finally, virtual mediation, which boomed during the COVID-19 pandemic, appears to be here to stay.[159] However, it is important to be cognizant of the pros and cons of virtual mediation. As seen in the *Boy Scouts* bankruptcy, a hybrid mediation process, with some in-person and some virtual participants, may create a sense of unfairness among the parties and impede their willingness to reach an agreement. On the other hand, virtual mediations may well be quicker and easier for the parties, because there is generally no need to travel, and anecdotal evidence suggests that they take less time than an in-person mediation.[160]

With these considerations in mind, mediation may well be beneficial to the Indian insolvency process, and India is well-positioned to adopt changes to that process.[161] In particular, considering the large caseload of the NCLT,[162] mediation could help take some of the burden off the court system by shifting some of the parties' efforts to an out-of-court process. Mediation can also help give parties other than financial creditors a say in the outcome of the process to the extent those parties are included.[163]

Prior to adopting an insolvency mediation program, however, it is important to consider mediation's fit within the insolvency framework. In the U.S., mediation is a natural fit because U.S. bankruptcy law is designed around compromise and settlement.[164] Bankruptcy judges and practitioners understand this and also understand that mediation can make compromise and settlement more likely.[165] For this reason, many bankruptcy courts in the U.S. have rules providing procedures for mediation or ADR.[166] However, for parties set on litigation, mediation may only serve to make matters worse, delaying the inevitable 'day in court.'

Ultimately, bankruptcy mediation is undoubtedly different from mediation in other litigation contexts. Yet, it has the potential to be an enormously valuable tool. A better understanding of mediation's pros, cons, successes, and failures will help India and the U.S. as both countries contemplate the future role of mediation in bankruptcy and insolvency law procedures.

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8

APPLYING MEDIATION IN CORPORATE INSOLVENCY SITUATIONS IN INDIA

— Misha, Shreya Prakash and Kritika Poddar

Executive Summary

The benefits of using mediation to resolve disputes are well known. In corporate insolvency situations, mediation can arguably serve a greater purpose since resources are limited and the need to save time and preserve business relationships is arguably higher. Globally, mediation has been extensively used both prior to commencement of formal corporate insolvency proceedings as well as during these proceedings, particularly when cases involve complex factual and cross-border issues. However, in India the use of mediation in insolvency situations has been limited. Given this background, this paper aims to assess if mediation can be gainfully employed in Indian corporate insolvency proceedings. This paper first gives an overview of the process of mediation and discuss the advantages of using mediation in insolvency specific situations. Secondly it analyses the practice and trends relating to the use of mediation in some key foreign jurisdictions. Thirdly, it applies learnings from academic material and international practice to show how mediation can be gainfully used in insolvency situations (particularly during formal insolvency proceedings). Lastly, it discusses the challenges of using mediation in insolvency situations in India and suggest certain reforms that may adopted to alleviate these concerns. Ultimately this paper argues that there is scope to apply mediation in corporate insolvency situations in India both prior to commencement of formal proceedings and even after such commencement. However, to support the use of mediation in practice, it is important for concerns regarding enforceability and capacity to be addressed.

Keywords: Mediation, Insolvency, Insolvency and Bankruptcy Code, 2016

INTRODUCTION

Mediation is a voluntary structured negotiation process where a neutral third party known as the mediator assists the parties in amicably resolving their disputes by using specialised communication and negotiation techniques.[1] Mediation *"(i) focuses upon the parties' own needs and interests, (ii) provides for a full disclosure of competing interests and positions (iii) confers upon the parties a right of self determination, (iv) allows for procedural flexibility and (v) maintains privacy and confidentiality"*.[2]

The role of the mediator in ensuring a successful mediation is to (i) separate the people from the issues (ii) remove hurdles to facilitate smooth communication (iii) suggest various creative settlements options (iv) assists the parties in reaching a final settlement agreement.[3]

Basis the type of conflict there are various models of mediation that can be adopted- facilitative, evaluative, court-mandated, and transformative. They employ different processes and envisage a different degree of intervention by the mediator. Facilitative mediation is more traditional in which the role of the mediator is to facilitate negotiations between the parties in conflict without revealing her own views regarding the dispute.[4] Evaluative mediation, on the other hand, envisages a greater role of the mediator. Mediators in this model have sector-specific expertise and aid the parties by providing an evaluation of the strength and weaknesses of their case basis the legal position.[5] This model tends to work well in cases where there is an uneven power dynamic between the parties.[6] In some cases, mediation is mandated by a court in the interest of promoting a speedy and cost-efficient outcome, and these are known as court-mandated mediations.[7] Finally, transformative mediation focuses on two key interpersonal processes- empowerment and recognition. The mediator aims to empower parties to make their own decisions but also works towards enabling parties to recognise each other's stance and point of view.[8]

A mediation process involves several stages that can be modified to achieve the desired outcome. A typical mediation, involves the following stages:

(a) Introductory and opening session: This session allows the mediator and parties to introduce themselves, and for the mediator to lay down the process she intends to follow to conduct the mediation process. The objective of this session is to gain the confidence of the parties and to create an environment instrumental to constructive negotiations.[9]

(b) Private sessions or caucuses: The mediator conducts private sessions with each party separately. This encourages parties to share confidential information with the mediator[10] that can help the mediator make a 'candid and frank assessment'[11] of the underlying interests of each party.

(c) Joint sessions: The mediator then conducts joint sessions to facilitate dialogue between the parties and give them opportunity to explain their own cases. The mediator encourages and promotes communication between the parties[12] and helps the parties reach a voluntary settlement agreement.[13]

(d) Closing session: Where the parties have agreed upon a settlement agreement, the mediator ensures that the agreement is reduced in writing and is signed by all parties in his presence. In the event, the parties are unable to settle the dispute, the dispute is referred to court. Statements made during the mediation are not disclosed or used by party before a court of law.[14]

NEED FOR MEDIATION IN INSOLVENCY PROCEEDINGS

The advantages of mediation in resolving traditional disputes are well-known. However, the use of mediation in insolvency situations is arguably supported by a much wider rationale than in other situations, since it is:

Vis-à-vis court proceedings

(a) Speedy and cost-effective: Pursuing judicial proceedings can be time and resource consuming which may lead to value destruction, particularly where the judicial system is already inundated with matters and delays are rampant. Mediation is more resource conscious as there is limited discovery or formality of procedure, and parties can control the time spent on proceedings.[15] Moreover, there may be centralisation of dispute resolution as well, which may not be possible when bankruptcy courts have only limited jurisdiction and cannot adjudicate on 'non-bankruptcy' aspects of various matters. This makes it a cost-effective option which the parties are keen to explore specially in insolvency proceedings, where the need to preserve time and costs is even greater.

(b) Confidential: In court-supervised insolvency proceedings, parties are generally hesitant and unwilling to share critical information which leads to information asymmetry and coordination problems. Since confidentiality is procedurally incorporated in a mediation process, parties are more at ease about sharing information about their reservation points which is likely to result in better settlements.[16] The private and confidential surrounding of a mediation process also helps obviate the social stigma around insolvency for financially troubled companies.[17]

(c) Flexible: Since mediation only involves the consent of the parties and is not bound by statutory authority, it can help in creating out-of-the box, creative and potentially, more satisfactory outcomes for parties than court-led proceedings.[18] Often parties' interests are not reflected in law, or the law may only allow straitjacketed outcomes. However, as mediation is based only on consent, it allows parties to develop outcomes and explore creative, out-of-the-box solutions that they are more likely to adhere to than formal court-imposed judgements.[19] Parties can also control the outcome of the dispute and avoid the inherent uncertainty associated with litigation, particularly where legal issues are not settled or divergent legal views are likely, for instance in cross-border cases.

(d) Preservation of relationships: The use of mediation can help save business relationships. This is particularly crucial in insolvency situations, when attempts are being made to rescue the business as a going concern and negotiations with multiple parties can lead to coordination problems.[20] Since mediation is not an adversarial process, there is no loser, as is the case in litigation, and it can help preserve relationships.[21]

Vis-à-vis negotiations

(e) Mediation can help correct power imbalances and engender trust in negotiations: The situation of financial distress significantly influences the debtor-creditor relationship, making interactions between the parties more complicated and difficult.[22] Unregulated negotiations between the debtor and creditor, or differently placed creditors may be affected by the power imbalance between debtors and creditors. The natural power of one party can be used to influence the settlement to the detriment of the other party, which may lead to resentment and difficulties in enforcement.[23] This power imbalance may also manifest as lack of trust, which could subvert any negotiations. The appointment of a professional, expert mediator can help correct power imbalances and achieve mutually beneficial settlements.

(f) Mediation can assist meaningful negotiations*:* Quite often actors in insolvency situations do not possess the right skills or have the right mindset to conduct successful negotiations.[24] Mediators may apply their skills to help advance negotiations and assist by engendering a culture of negotiation between parties.

INTERNATIONAL PRACTICE AND TRENDS

The adoption of mediation in insolvency proceedings has become an increasingly popular practice across the world. Countries have incorporated mediation both in their pre-insolvency and insolvency proceedings. Mediation can be used pre-commencement of formal proceedings,[25] to facilitate negotiation and confirmation of plans,[26] to evaluate claims[27] and in relation to avoidance actions.[28] Mediation has worked not only in domestic single debtor cases but has, in fact, gained most traction when employed in complex cross-border insolvency and group insolvency cases such as *Lehman Bros.* and *Enron.*[29]

International Practice

The manner in which mediation has been applied in insolvency situations in some key jurisdictions is discussed below:

United States

The United States (US) has been at the forefront of applying mediation at various stages of bankruptcy proceedings, including claim settlement and plan settlement. In 1998, the US adopted the Alternative Dispute Resolution Act which requires all federal trial courts to implement alternate dispute resolution (ADR) methods and granting judges the authority to send a case to mandatory ADR procedures, including mediation. This law explicitly requires that each district court provide at least one ADR process, including, *'early neutral evaluation, mediation, minitrial, and arbitration'.*[30] In addition to this, the Federal Rules of Bankruptcy Procedure[31] delegate the authority to federal district courts to make and amend local rules governing practice and procedure in bankruptcy cases and proceedings. However, in almost every district, the local bankruptcy rule-making power to has been delegated to bankruptcy judges.[32] As a result, most federal district courts permit the use of mediation, in some form, by local rule. Moreover, even in districts where local rules do not provide for mediation, it is employed on an on *ad-hoc* basis in Chapter 11 cases.[33] Several bankruptcy courts such as those of Eastern District of New York[34] and Central district of California,[35] have also established mediation programs to '*provide litigants with the means to resolve their disputes more quickly, at less cost, and often without the stress and pressure of litigation*'. While the participation of parties in mediation programs is generally voluntary, the judge on its own accord or at the request of a party may refer the matter to mediation.[36] The parties are normally given the option to select a mutually acceptable mediator and an alternate mediator. However, if the parties cannot agree, then the Judge can appoint a mediator and an alternate mediator from the panel.[37]

Mediation has been extensively used in various stages of a Chapter 11 proceedings under the US Bankruptcy Code:

(a) Claims Mediation: Mediation has been used to settle contingent and unliquidated tort claims including claims relating to personal injury and property damage. *NLRC v. Greyhound Lines*[38] was one of the first cases in which ADR methods were used to settle thousands of claims in connection with road accidents. The use of mediation in this case was particularly important as the bankruptcy court did not have jurisdiction to deal with claims relating to wrongful death and personal injury and in the absence of mediation, the debtor would have been forced to resolve these claims in multiple locations with multiple attorneys.[39] The mediation process adopted in this case involved three distinct stages[40]- first, the claimants were required to complete a standardized claim form; second, if the debtor denied liability or the claim could not be settled, then the parties engaged in mediation for a period of sixty days; and third, if mediation was not successful, then the claimant had the option of pursuing arbitration. As a result, more than ninety-five percent of the pre-petition tort claims were resolved through this mediation process.[41] Claims mediation was also successfully applied in the Chapter 11 bankruptcy of Lehman Brothers. In this case, claims relating to 1.2 million derivates transactions with over 6,500 different parties was dealt with through mediation. [42]

(b) Single creditor mediation: These involve mediations relating to single creditors. For e.g. in *re Kovalchick*,[43] disputes between the debtor and secured creditor were referred to mediation.[44] Such mediations may be particularly important in debtor-in-possession situations where a single creditor has the power to block plans.

(c) Plan Mediation: Use of mediation in negotiating a Chapter 11 payment plan is particularly helpful as the parties can efficiently reach an agreement without infringing on the bankruptcy court's authority to approve the same. This is because the mediator has no binding authority to decide the outcome of the case.[45] Plan mediation can also be used to mediate impasses in the formulation of a plan or to mediate plan related disputes.[46] In the case of *MF Global Holdings Ltd*, separate insolvency proceedings were commenced in the US as well as in the UK, with both estates cross-claiming. Mediation helped in plan settlement in this case.[47]

(d) Avoidance Actions: Mediation has also been applied by the bankruptcy courts to settle preference actions, turnover actions, and other adversary proceedings.[48] In some jurisdictions, mediation is even mandated for such claims.[49]

(e) Post confirmation of plans: Some reorganisation plans have terms relating to claims mediation after the plan is confirmed.[50] For instance, in the case of *Johns-Manville*[51] the confirmed reorganisation plan involved the creation of a settlement fund for the purposes of compensating the claimants and provisions for claims mediation to address their claims.[52] Similarly, in the case of *re A.H. Robins*[53] the confirmed plan provided for the establishment of a settlement fund for the benefit of the claimants and also provided claimants with 'instant settlement offers' in exchange for releasing their claims against the debtor. [54]

(f) Cross-Border insolvency: These primarily tend to focus on the distribution of the estate to creditors from different countries, and the coordination of insolvency proceedings ongoing in different jurisdictions. In *Olympia & York Case,* where insolvency proceedings had commenced in both the US and Canada, a mediator was appointed to "*(i) harmonize the Canadian and US proceedings; and (ii) bring about a consensus among the parties regarding corporate governance issues*".[55]

(g) Group Insolvency*:* These mediations may relate to resolving disputes with intra-group claims, their treatment in plans and the coordination of different proceedings, to allow for more value-maximising resolutions. In *Enron*, for example, mediation procedures were applied by an examiner appointed to mediate plan disputes relating to a group company. The mediation facilitated the preparation of a joint plan for all group debtors. Mediation was also applied to deal with specific derivatives claims.[56]

Japan

An out of court work out mechanism called Turnaround ADR was established in 2007 vide an amendment to the Act on Special Measures for Industrial Revitalisation and Innovation which is presently known as the Act on Strengthening Industrial Competitiveness. It is a process which is outlined to facilitate negotiations between distressed debtors and its financial creditors under the supervision of licensed mediators. The Japanese Association of Turnaround Professionals (**JATP**) is the first and only licensed organisation permitted to mediate Turnaround ADR cases.[57]

The JATP only permits the debtor to proceed with Turnaround ADR if there is a reasonable possibility of successfully restructuring the debtor's business and thus it is crucial that the debtor has a business turnaround plan prepared beforehand.[58] A panel of three mediators is appointed to oversee the process- one lawyer, one accountant and one consultant or another lawyer, each with a background in business rehabilitation.[59]

Some key features of the process are:[60]

(a) After the acceptance of a formal application at the behest of the debtor, the JATP sends a 'standstill notice' to the financial creditors whom the debtor wishes to involve in the process. Typically, only banks are involved in the process.

(b) After the standstill notice is issued, debtors are not required to pay loan principals but are expected to pay the trade creditors in the ordinary course of business required to keep the business as a going concern.

(c) The process is usually confidential except in some cases involving listed companies.

Three types of creditors meetings are held where the business plan is discussed and voted on by the financial creditors.[61] The mediators assess the economic viability of the plan and submit a report to the participating financial creditors. To validate the plan, a unanimous vote of the creditors approving the plan is required. In the event that one or more creditors reject the proposed plan, the Turnaround ADR is immediately terminated.[62] In such a case, the debtor two options- (i) to use another mediation process known as special conciliation proceedings which is presided over by a judge and attempts are made to reach a consensus with the dissenting financial creditors[63] or (ii) to file legal insolvency proceedings which may be civil rehabilitation proceedings under the Civil Rehabilitation Act (Act No. 225 of 1999) or corporate reorganisation proceedings under the Corporate Reorganization Act (Act No. 154 of 2002).[64]

Australia

Both federal and state level courts in Australia are empowered by statutory provisions to refer parties to mediation and other ADR processes. Section 53A of the Federal Court of Australia Act, 1976 allows courts to refer parties to mediation with or without their consent. The same is not true for arbitration, as the parties' consent is required for such referral.[65]

The Civil Dispute Resolution Act 2011 mandates the filing of a 'Genuine Steps Statement' before filing an application in a Commonwealth Court such as the Federal Court or the Federal Magistrate Court.[66] The Genuine Steps Statement must specify the steps that have been taken to resolve the dispute between the applicant and the respondent[67] or the reason why no steps were taken which may relate to *inter alia* the urgency of the proceedings or the safety and security of any person or property.[68]

These genuine steps include (i) intimating the other party of the issues in dispute along with an offer to discuss them (ii) providing relevant information and documents (iii) consideration and/or participation in ADR and (iv) negotiation.[69]

In insolvency related matters, Federal 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.[70] A delay or failure to agree to mediate or a failure to mediate in good faith can result in imposition of costs on the party and even her legal representative. The filing of Genuine Steps Statements by parties may be considered while awarding such costs.[71]

United Kingdom

In the United Kingdom (UK), the courts have supported the use of mediation in appropriate cases.[72] The Chancery Courts Guide 2016 (Guide) encourages the use of ADR methods, particularly mediation.

The Guide provides for the settlement of disputes by means of alternative dispute resolution.[73] It imposes an obligation on the legal representatives to consider with their clients along with other parties involved to explore alternative dispute resolution options to resolve disputes or particular issues. It further requires the legal representatives to keep their clients informed of the most cost-effective means of resolving the dispute.[74]

Wherever appropriate, courts will encourage parties to use ADR to settle cases or particular issues.[75] Usually, courts will not make an order directing the parties to undertake a form of ADR. However, if parties are unreasonably refusing to attempt ADR, the court may direct the parties to take reasonable steps to consider ADR.[76]

Spain

In 2013, Spain established an extra judicial procedure in its Insolvency Act known as 'out-of-court payment agreement' (OCPA) also known as 'insolvency mediation'. The purpose of this procedure is for the debtor to reach an agreement with their creditors based on a proposal made by an 'insolvency mediator'.

This procedure can be availed by (i) consumers and sole proprietor whose liabilities are not more than five million euros and (ii) non-financial corporations who have fewer than 50 creditors and whose assets and liabilities are lesser than five million euros.[77] It is initiated by the debtor who makes a request for the appointment of an insolvency mediator.[78] While the debtor negotiates this agreement, creditors cannot institute enforcement proceedings (court or out-of-court) for a period of three months.[79] Additionally, OCPA can be imposed on dissenting creditors if certain voting majorities are achieved.[80]

The insolvency mediator prepares a settlement plan for credits, together with a feasibility plan and a continuation plan of the professional or business activities of the debtor, including a negotiation proposal of the debtor's loans and credits. The plan should be approved by the vote of the creditors of at least 60% of the liabilities, and 75% if the plan consists in having the debtor transfer his assets as a payment for his debts.[81]

Singapore

While mediation has not been used extensively in restructuring cases in Singapore so far, Singapore has taken steps to encourage the use of mediation in insolvency proceedings. In the case of *Re IM Skaugen SE*,[82] for instance, Justice Kannan Ramesh remarked that deploying the services of a skilled mediator in developing a restructuring plan can help in building trust and consensus between the parties and can '*iron out many of the wrinkles and creases that frequently erupt in a restructuring and which perhaps are not resolved in the adversarial cauldron of the court*'.

In 2015, the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (Committee) was appointed with the task of recommending legal reforms to strengthen Singapore as a centre for international debt restructuring. The Committee recommended that:

(a) Where disputes can be efficiently resolved through ADR methods including mediation, judges should be empowered to encourage parties to take recourse to mediation.[83]

(b) Local mediation institutes such as Singapore International Mediation Centre should develop rules and protocols specifically targeting insolvency disputes to attract potential users.[84]

(c) Panels of mediation bodies should be strengthened to include expert mediators with experience in cross-border restructuring or insolvency practitioners should be encouraged to undergo the necessary training to mediate such matters.[85]

The Committee also observed that mediation can be used: [86]

(a) to resolve individual creditor disputes with the debtor (in the context of a multi-creditor restructuring);

(b) to manage multiple creditor disputes of the same nature (similar claims mediation) where a mediator is appointed to resolve multiple claims with a common nexus of law or fact;

(c) in plan mediation where a mediator is appointed to achieve consensus in a restructuring plan between the debtor and its creditors or where debtors are subject to multiple insolvency proceedings in competing jurisdictions.

The Committee also noted that similar to the practice in the US where judges often encourage parties to mediate in bankruptcy cases, the courts in Singapore could follow suit.[87] Additionally, the Committee recommended that provisions permitting courts to refer parties to mediation should be incorporated in statutes for resolution of disputes in insolvency and restructuring proceedings.[88]

Recently, the United Nations Convention on International Settlement Agreements Resulting from Mediation also known as the Singapore Convention of Mediation was enforced on 12 September 2020. This Convention provides for a framework (consistent with global practices) for cross-border enforcement of mediation settlements involving parties and assets in multiple jurisdictions,[89] which may provide a fillip to the use of mediation in restructuring/ insolvency proceedings.

Key trends and learnings

Broadly, the experience of other jurisdictions suggests that:

(a) Mediation can be incorporated as part of an 'out-of-court' workout mechanism*:* Countries such as Spain and Japan have developed stylised, out-of-court workout mechanisms in which mediation plays a significant role in helping parties come to a 'resolution'. These out-of-court mechanisms have some features of formal proceedings, such as the extension of a moratorium and cram-down as well.

It is important to note that these procedures do not only help in the settlement of individual debts but help in preparing resolutions vis-à-vis all of the company's creditors. Subject matter experts are appointed as mediators and are expected to help in the creation of or assessment of repayment/

turnaround plans. The mediator can adopt different techniques to persuade and assist parties in establishing 'a common ground for cooperation in the exchange of the financial and other information necessary for meaningful plan negotiations'[90]. The mediator can also aid in other managerial aspects of a plan mediation such as coordination amongst creditors for the purposes of voting on the plans or organising meetings between the debtor and creditors.[91]

(b) Mediation can be used to address traditional 'disputes' e.g. avoidance actions in insolvency situations: Countries such as the US place emphasis on using mediation to resolve avoidance actions. Since these actions often involve heavy factual determinations by courts, and may involve expenditure of significant time and money, mediation is encouraged as an alternative to court-led dispute resolution for avoidance actions.[92] Similarly, mediation may also be used to resolve disputes with single creditors.[93]

(c) Mediation is used successfully in complex cases, where the legal position is not always clear: Experience from large cases such as *Lehman*[94] and *Maxwell Communications* has shown that mediation is very useful in cross-border insolvencies and determination of complex claims where there is a divergence/ uncertainty of legal position. For instance, in the bankruptcy of *Maxwell Communications,* proceedings were commenced in both the US and the UK, and an 'examiner' was appointed to mediate and '*resolve conflicts among the jurisdictions and, ultimately, to develop a coordinated plan and scheme that harmonized US and UK insolvency law*'.[95] In *Lehman Bros*. claims mediation was particularly helpful since it involved complex, factual issues, and had it gone to litigation, could have resulted in different outcomes in different national courts, that could have been conflicting.[96] In such cases, mediation helps in providing a centralized 'adjudication system'.

(d) Mediators can play a 'coordination' role in insolvency proceedings: Experience from cases such as *Enron*[97] and *MF Global Holdings Ltd*.,[98] shows that mediation can help in 'coordinating' different aspects of insolvency proceedings. For instance, mediation helps in coordinating with creditors for the purposes of voting on the plans or organising meetings between the debtor and creditors, in respect of reorganisation plans.[99] Similarly, in case of group insolvency situations, mediation can facilitate coordination of meetings between the debtors and other key stakeholders, which can result in coordinated reorganisation plans.[100]

(e) Parties are often referred to mediation by courts and/or by law: While mediation is generally a voluntary procedure, experience from jurisdictions such as Australia show that courts can refer parties to mandatory mediation, if they unreasonably refuse to engage in the process. Mandatory mediation encourages parties to make a serious attempt at resolving their disputes at an early stage.[101] Further mandatory mediation eliminates the parties' concerns of appearing weak or uncertain of their success at litigation.[102] Similarly, in case of specific types of cases, e.g. avoidance actions, rules may mandate that parties attempt mediation before approaching the court.[103]

This experience may be instructive while applying mediation to Indian insolvency proceedings.

MEDIATION IN INDIAN INSOLVENCY PROCEEDINGS

Presently, mediation is used in India pursuant to parties' choice to resolve contractual disputes or under section 12A of the Commercial Courts Act, 2015 which mandates pre-institution mediation. In some cases, mediation may have to be resorted to by an order of court under section 89 of the Code of Civil Procedure, 1908, or under other special legislations such as section 37 of the Consumer Protection Act, 2019.

Despite mixed response to mediation in India, there is a growing demand that mediation be utilised more prior to or in insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 (Code).

Proponents of mediation argue that it could help alleviate stress on Adjudicating Authorities, whose low capacity has contributed to large-scale delays in insolvency processes under the Code.[104]

Analysis of academic material and foreign practice in sections covered above, also shows that mediation could potentially be employed gainfully in the following stages under the Code. It may be noted, however, that certain provisions in the Code may also need to be revised, in order to create scope for mediation, particularly to resolve avoidance actions, claims disputes, etc.

(a) Pre-insolvency commencement: Mediation may be attempted prior to the commencement of formal insolvency proceedings both under sections 7 and 9 of the Code which would obviate the need to start court-supervised insolvency proceedings. In practice too, negotiations often take place prior to initiation of formal insolvency proceedings with an aim to reach a settlement or a restructuring agreement with the corporate debtor.[105]

(b) For settlement after admission of the corporate insolvency resolution process (CIRP**):** Mediation may also be applied for successful settlement of debts even after admission of the CIRP both before and after constitution of the committee of creditors (CoC). Prior to constitution of the CoC, mediation has been successfully attempted in the case of *V.K. Parvinder Singh v. Intec Capital Ltd. & Anr.*[106] Where a settlement plan was reached before the CoC was formed and as a result CIRP was suspended.

Mediation can also result in a settlement after the formation of the CoC to enable withdrawal of an insolvency application under section 12A of the Code. Use of mediation at this stage may also result in reverse CIRP in cases of real estate companies.

(c) Use of mediation in pre-packs/ Reserve Bank of India (RBI) June 7 circular: Similar to the position in Japan and Spain where mediators help the debtors in the preparation of a resolution plan in their out-of-court mediation mechanism, mediation may also be adopted to develop a resolution plan pursuant to the RBI's Prudential Framework for Resolution of Stressed Assets (June 7 circular) or for the preparation of a base resolution plan under the pre-pack resolution framework for micro, small and medium enterprises. Mediators can assist the corporate debtor and creditors in negotiating and developing a mutually agreeable strategy for resolution.

(d) Claims Mediation: Mediation could help settle disputes relating to claims. This may include:

- disputes relating to the quantum of claims made by and against the corporate debtor during CIRP or liquidation.

- disputes relating to classification of creditors. For e.g. a resolution professional ("**RP**") admitting a creditor as an unsecured one when the creditor considers itself as secured one, or when the RP has failed to consider a financial creditor's exclusive charge over an asset while computing liquidation value.

- There is scope for mediation in resolving such disputes.[107] However, mediation ought to be applied in a manner that third-party interests not affected without the consent of such third-parties. This is likely to be achieved when litigation is likely to be too time-consuming and third parties are also convinced that certainty of mediation would be preferable to a litigated outcome.

(e) Disputes relating to assets: Mediation may also be helpful in cases where disputes relating to the ownership of assets arise when the RP takes possession of the debtor's assets and the liquidator forms the liquidation estate. For e.g. in the insolvency of *Lehman Bros*., claims' mediation was conducted to resolve cases where counter-parties claimed that some assets were held in trust for the benefit of third parties, and were not part of the estate.[108]

(f) Third party disputes: Disputes may occur with third parties that are not creditors of the corporate debtor. These disputes may threaten the preservation of the debtor as a going concern both during the CIRP and under a resolution plan. For e.g. where a third-party owns land on which the corporate debtor's premises are situated but refuses to extend the lease of the land in a resolution plan. In these situations, mediation may help resolve disputes and result in a negotiated settlement.

(g) Inter-creditor disputes: These disputes may manifest themselves most notably in cases relating to distributions under resolution plans, with dissenting creditors wanting different terms from the plan. Where a cram-down is not possible or is likely to lead to litigation, mediation may help creditors find alignment in their interest and settle how their dues should be paid out from a specific kitty allotted by resolution applicants.[109]

(h) Post approval of resolution plans: Disputes may arise between the CoC and the successful resolution applicant after a resolution plan has been approved by the Adjudicating Authority. Such disputes may be successfully mediated and are more likely to provide agreeable outcomes, more so, as the assumption here is that both the CoC and the successful resolution applicant have a common objective viz. implementation of the resolution plan. The use of a mediator in such disputes can help facilitate dialogue between the parties but would perhaps be more useful if the NCLT itself is given adjudicatory power over post-approval actions, which it does not currently enjoy.

(i) Avoidance transactions: Mediation could be used successfully in relation to avoidance actions, particularly as the adjudication of avoidance actions takes time and involves extensive factual determination by the Adjudicating Authority. Attempting mediation in respect of avoidance actions could help in swelling the asset pool of debtor, in a cheaper and more time bound manner than typical avoidance actions that often continue, even after the resolution plan has been approved under the Code. In some jurisdictions, such as Delaware, mediation is mandated for certain types of avoidance actions.[110] However, mediations may work best in relation to those avoidance actions, which do not require fraud or *mala fides* to be established or when the Adjudicating Authority itself directs these to be considered.

(j) Cross-border issues: As experience in cases like *Lehman* have shown, mediation can prove particularly useful in cross-border insolvency cases. Mediation may be used to settle disputes relating to crossclaims by the estates in different countries or settlement of claims of creditors claiming in both countries. Mediation may assist parties in coming to an agreement on Cross-border Insolvency Agreements to facilitate cooperation and coordination between proceedings in different countries, and once they have entered into such agreements, provisions for dispute resolution through mediation may be incorporated in such agreements. These disputes may relate to the interpretation of the agreement or even to disputes/ conflicts in the insolvency proceedings themselves.[111]

(k) Group Insolvency Issues*:* In case of group insolvency proceedings, mediation may help resolve disputes arising from multiple insolvency proceedings. These typically tend to manifest as disputes regarding claims or plans. The UNCITRAL Model Law on Enterprise Group Insolvency also advocates the use of mediation to resolve disputes between enterprise group members concerning claims, whether arising within or outside the enterprise group.[112]

Basis the nature of dispute, stage of the resolution process and the preference of the stakeholders involved, a mediator may adopt an appropriate model of mediation or alternatively may adopt characteristics of different models to conduct the process. For e.g. in a pre-insolvency mediation, elements of transformative, facilitative and evaluative mediation may assist the parties in reaching an agreeable outcome. In such a mediation, the mediator in addition to facilitating negotiations between the creditor(s) and debtor can encourage them to be empathetic towards the commercial needs of one another and settle the dispute without the intervention of the court by providing them with an evaluation of their strengths and weaknesses and likelihood of success or failure at litigation. Likewise, to resolve plan related disputes which require a meticulous understanding of the Code, an evaluative mediation model with an insolvency expert as a mediator may provide the most satisfactory outcome for the parties.

CHALLENGES IN APPLYING MEDIATION IN INSOLVENCY PROCEEDINGS

Despite this potential, and no prohibition on the use of mediation in insolvency proceedings, mediation has not been employed extensively in Indian insolvency proceedings so far. In fact, in the five years since the provisions of the Code came into force, only a handful of cases reportedly employed mediation.[113] Interestingly, most of these cases have applied mediation to facilitate the settlement of debt of the creditor who made the application to initiate insolvency proceedings, so that the creditor withdraws the application for the insolvency proceeding,[114] and there have been no reported cases indicating the use of mediation during the insolvency process to formulate resolution plans, etc.

Some key factors that could explain the lack of its widespread use in insolvency proceedings are:

(a) **Lack of awareness:** Awareness around the use of mediation and the benefits it yields as an effective tool for dispute resolution gravely lacks amongst the public.[115] Experience from use of mediation in context of civil and commercial disputes, etc. shows that there are various perceptions around the use of mediation. Firstly, that mediation provides '*lesser form of justice and is only second to litigation'*.[116] Secondly, parties who suggest or attempt mediation are perceived to be weaker.[117] These perceptions arise from the fact that mediation is still an unfamiliar and misunderstood process for many.[118] Lack of structured dissemination of data relating to success rates of mediation, cost efficiency and overall benefits of mediation also contributes to low awareness amongst the public.[119]

(b) **Lack of binding nature of mediated settlements:** While mediation has been incorporated in individual legislations as mentioned above, there is no existing comprehensive framework governing mediation. Lenders are hesitant to incorporate mediation as a method of dispute resolution in their contracts as there is lack of clarity around enforceability and breach of mediated settlements.[120] The lack of clarity on enforceability of a mediated settlement also adds to the perception that mediation is not an alternative to litigation. Moreover, in insolvency proceedings, the outcome of mediated settlements may affect third party rights too, e.g. in case of claims mediation, and as mediation would not be able to bind third parties, litigation may be preferred.

(c) **Lack of statutory provisions/incentives to engage in mediation:** Since financial creditors in India are regulated by the RBI, they prefer to adopt formal and statutory mechanisms for debt recovery. There is little incentive for banking institutions to engage in mediation as they have sufficient statutory provisions to resort to for debt recovery. Our interviews with legal practitioners revealed that lenders are hesitant to adopt mediation in the absence of statutory provisions that provide them with the option to resort to mediation for resolution of disputes or alternatively require them to sincerely attempt mediation for particular issues.[121] Moreover, in cases of financial creditors, especially public sector banks, there is an inherent lack of internal organisational flexibility and such creditors may prefer to obtain an order from a court of law as opposed to engaging in an informal process for insolvency matters.[122] In fact, our analysis of the Singapore law also shows that in the absence of the legal provisions, parties have rarely resorted to mediation in insolvency matters despite the encouragement from courts.

(d) Lack of capacity/ specialisation: There is a dearth of specialised institutions for insolvency mediation with experienced empanelled mediators specialising in the field. Presently, mediation is not treated as an independent profession and as a result is not in included in the curriculum at educational institutions.[123] Challenges relating to capacity are exacerbated due to regional inequities as well.[124]

REFORMS

To alleviate the concerns listed above and ensure that mediation can be employed gainfully in insolvency situations, the following legal and institutional changes may be considered:

(a) Incorporation of statutory provisions: There is immense scope to use mediation at various stages of the Code, however, as discussed above, stakeholders often lack the necessary incentives to attempt mediation. In this regard, various foreign jurisdictions such as US, UK, France, and Japan have statutorily provided mediation, in some form and manner, as an option for dispute resolution in their respective insolvency proceedings.

In India too, it may be helpful to incorporate provisions in the Code to empower the Adjudicating Authority to encourage and refer parties to mediation in appropriate cases or to resolve particular issues. However, given that mediation may not be useful in all circumstances, Adjudicating Authorities should only do so in where the use of mediation would help reduce time and costs for parties, and there should be no mandatory requirement to mediate.

For out-of-court mechanisms such as the June 7 Circular or for pre-packs, the RBI circular and Code, respectively may expressly recognise that mediators may be appointed by parties to come to a negotiated resolution plan or base resolution plan, as the case may be.

(b) Create awareness regarding mediation for stakeholders in the insolvency eco-system: Merely referring parties to mediation may not result in positive outcomes if parties themselves are unwilling to mediate. To alleviate this, government agencies such as Insolvency and Bankruptcy Board of India (IBBI) may consider creating awareness about the use of mediation, its benefits, and the possibilities of its success in insolvency proceedings that will motivate stakeholders to resort to mediation.

In this regard, they may also set up an online platform which can serve as a repository of accredited insolvency mediators (including mediators empanelled under the Companies Act, 2013), and mediation institutions. This platform may help connect stakeholders in the insolvency eco-system with relevant mediators and institutions.

(c) Capacity building initiatives for mediation practitioners and institutions: In addition to creating awareness relating to mediation, it is important to ensure that there is a sufficiently developed mediation eco-system.

Specifically, mediators must understand the goals of insolvency and the insolvency process as well, particularly in cases where parties would prefer evaluative mediation. Mediation centres may consider carrying out insolvency-focussed training for mediators who are interested in mediating insolvency related disputes. They may also accredit mediators who undertake such training[125]

It may also be relevant for institutions that can provide mediation services to come up with protocols and rules that can be applied easily to insolvency mediation. IBBI may help in the development of such institutions and recognise institutions with adequate infrastructure capacities and a sufficient number of accredited insolvency mediators.[126]

As discussed above, mediation has different success in different parts of the country and accordingly capacity building initiatives may need to take into account regional divergence, etc. as well.

(d) Making mediated settlements binding and enforceable*:* Finally, mediation will emerge as a viable alternative to court-led proceedings if parties are secure that their settlements will be considered binding and will be easily enforceable. One way in which this can be done is by ensuring mediated settlements are incorporated in orders of the Adjudicating Authority. Another may be done by creating a legal framework for use of mediations that addresses the issue of enforceability. Efforts have been made to address this lacuna with India signing the Singapore Convention of Mediation which provides an effective framework for cross-jurisdictional enforcement of mediated settlements and the introduction of the Mediation Bill, 2021 in the Rajya Sabha which provides for *inter alia* a structured framework for the conduct of mediation and enforceability of mediated settlements.[127]

Together, such initiatives will help develop a preference for mediation in insolvency proceedings and enable the stakeholders of the Indian insolvency eco-system to tap the benefits of mediation.

CONCLUSION

There is immense scope of using mediation beneficially both pre-insolvency and also after the commencement of proceedings under the Code. Experience from other jurisdictions indicates that use of mediation to resolve a range of issues, including avoidance action disputes, disputes relating to claims, disputes relating to resolution plans and cross-border issues could reduce judicial burden and also further the objectives of the Code of providing time-bound justice and maximisation value for all stakeholders. However, mediation has not been used extensively insolvency proceedings *inter alia* due to concerns relating to the enforceability of mediated settlements, lack of sufficient incentives to employ it and concerns relating to capacity. If steps are taken to address these concerns, mediation could be employed usefully in insolvency situations in India.

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9

ASSESSING BEHAVIOUR CHANGE OF CREDITORS UNDER IBC

— Neeti Shikha, Shambhavi Singh and Rishabh Ahuja

Executive Summary

Insolvency laws offer a natural insight into the economic analysis of law. Insolvency scholarship is based on the basic assumptions of standard economic concepts of choice, behaviour and incentives. This study begins with the premise that people make choices in a rational manner in order to maximise their individual utility.

The study looks at how the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) interacts with components of behavioural economics in order to better understand the choice architecture that the legislation provides in order to steer stakeholders toward desired outcomes. It looks at the Code through the prism of behavioural principles to see how it 'socially engineers' a certain behaviour among key stakeholders in the insolvency and bankruptcy framework.

According to the authors, the reduced default threshold of ₹ 1 lakh served as a nudge to limit corporate debtor behaviour. Assessing the number of cases filed under section 9 and evaluating their outcomes, such as how many were resolved versus those that went to corporate insolvency resolution process (CIRP), provided compelling evidence.

The application of behavioural economics throws light on the nature of borrowers' and creditors' concerns about the loan market, as well as how regulation could be used to alleviate these concerns. The study highlights that to achieve IBC's goals, tools from the behavioural economics domain should be used. The government should also consider providing out-of-court solutions to defaults. Additionally, IBC research should not just look at the results, but also at what generates such behaviour. Insolvency problems, like many other financial services, entail complex information, making decisions over time, and assessing risks, all of which have been the subject of behavioural economics research.

Keywords: Behavioural Economics, CIRP, Default Threshold, Reforms.

INTRODUCTION

The design of law in a particular society is dependent upon the collective thinking of the society in terms of what is desirable and what is a not so desirable action. The structure of incentives and deterrents in the law is dependent on this collective thinking which then encourages socially desirable actions and penalises undesirable actions. Appropriately designed legislation and efficient enforcement can provide incentives to agents to choose what is the best, or the most desirable, outcome, or, in the language of economics, the most efficient outcome.

This article explores the interplay between the IBC and aspects of behavioural economics in an attempt to elucidate upon the choice architecture the law offers in order to drive the stakeholders in the system towards envisaged outcomes. It examines the Code with the lens of economic behavioural principles to assess how it is using these principles to 'socially engineer' a particular behaviour among the key players in the insolvency and bankruptcy framework.

The experience of US bankruptcy law history shows us the dynamic nature of such the Code, which needs to be tweaked or amended as per evolving and unanticipated situations. The Code certainly helps in resolution of NPAs, but its long-term and bigger impact will be on unseen behavioural aspects in the economy. The law as it stands lends transparency and predictability to the resolution process itself. But its significant impact will be in cases that will never come up for the Code-mandated resolution, because of the deterrence and change in players' incentives. The real success will lie in the fact that the borrowers change their behaviour and pay back to the creditors on time. Thus, in the coming years, the large measure of success would be in unobserved data, not in the number of cases that come up for resolution. In the long term, its effect will also manifest itself in behaviour such as extra effort to avoid repayment default, lesser resources locked up in defaulting or under-litigation economic activity, and lower cost of credit.

Creditors under the IBC are usually caught between Scylla and Charybdis as neither resolution nor liquidation may help them recover the full loan amount. As a result, the fundamental objective of the Code which is the revival of the company and maximisation of value for 'all' stakeholders fails to achieve its purpose. To counter this malaise, Insolvency and Bankruptcy Board of India (IBBI) introduced the code of conduct for creditors. So now Indian insolvency law has been able to 'regulate' the conduct of the Insolvency Professionals (IPs) by a series of disciplinary proceedings and judgments that it sets as a precedent. It can now regulate the conduct of the committee of creditors (CoC) through this Code. The paper discusses some of the cases which have developed ethical behaviour among IPs under the IBC. It argues there is a gap of such precedents in the case of creditors, and much is then left to the creditors themselves to evaluate their ethics. Court judgments too have not helped much in this regard. The commercial wisdom of creditors are disposed of with ethical consideration and there is a lack of any nudge that could push them towards resolution. After all, the decision makers will prioritise rescue over recovery only if the incentive for doing so is rightly aligned and there is enough safeguard for risk takers.

Through a series of case laws and data, the paper shows that the lower default threshold of ₹ 1 lakh worked as a nudge to regulate the behaviour of corporate debtors (CDs). Assessing the number of cases filed under section 9 and evaluating the outcome of the cases, measuring how many of them got settled as compared to those that went into CIRP will offer strong evidence.

Further, recounting major amendments in the IBC and seeing the impact of those in terms of number of applications for CIRP, liquidation and settlement will offer an insight into what changes in law yielded positive results.

There is a need to bring a behavioural change among the creditors which can happen only if the issue is addressed from the time the loan is advanced. The Code alone may not change the behaviour of the creditors and there is a need to reorient them towards resolution rather than recovery. The paper argues that banks should be nudged to think of long-term gains rather than short-term recovery. In this regard, behavioural economics should be consulted for countervailing potential solutions to the problem and for de-biasing the creditors towards focusing on upfront recovery. Further, it discusses some solutions that are designed by shifting incentives and that can hold the potential to be more effective than others.

If the resolution process for the debtors is not too draconian, its structure might combat the biases that contribute to controllable overborrowing and reinforce good attitudes about credit by debtors and creditors alike. So far, the legislature in India has not seriously considered a behavioural economics approach to change creditors' behaviour and make them focus more on resolution than recovery. But for what it might be worth, is educating in lending morality and company turnaround. Story sharing about creditors who consider resolution over recovery, shifting incentives for banks towards resolution, abrogating disincentives in the form of a myopic regulatory audit that punishes banks for letting go of higher recovery in order to save a company, are few, to begin with. In the end, the paper will offer some recommendations on how tools of behavioural economics can be adopted to bring a behaviour change.

INCREASED DEFAULT THRESHOLD UNDER THE IBC

The amendment of the minimum threshold of default from ₹ 1 Lakh to ₹ 1 crore under section 4(1) of the IBC was made by the Government of India vide notification F. No. 30/09/2020 dated March 24, 2020 issued by the Ministry of Corporate Affairs (MCA).

As a result of this, several opinions emerged as to whether fresh applications under section 9 of the IBC for initiating CIRP are maintainable against CDs in relation to defaults lower than ₹ 1 crore, which have occurred before March 24, 2020.

Section 4 falls under Part II of the IBC, which is the chapter providing for the insolvency resolution and liquidation for corporate persons and is a substantive provision which sets out the minimum threshold of monetary default to be met for enabling creditors to approach the National Company Law Tribunal (NCLT) by way of an application to initiate the CIRP against the debtor, who is in default of discharging a debt. Earlier, the threshold which the statue set forth was an amount of ₹ 1 lakh. However, the proviso to section 4 conferred power upon the Central Government to change the minimum threshold to any amount to the extent of ₹ 1 crore by notification.

With the onset of the unprecedented COVID-19 pandemic, the Ministry of Home Affairs (MHA), Government of India working in tandem with the State Governments on March 24, 2020, declared a complete nationwide lockdown by issuing orders under section 10 of the Disaster Management Act, 2005, in its effort to contain the spread of the pandemic, thereby bringing all economic operations to a complete halt. At that stage, the government permitted the undertaking of only certain essential activities, which were specified in the lockdown order. The March 24, 2020 lockdown order was from time to time replaced with various fresh orders, whereby other activities were opened up, keeping in view the prevailing circumstances.

The Central Government was well aware of the financial repercussions and distress which this extraordinary lockdown situation was likely to cause to businesses and therefore, the MCA in order to provide protection to the industry as a whole, used its inherent power under section 4 to raise the threshold to the maximum limit permitted therein, i.e., ₹ 1 crore vide its notification dated March 24, 2020.

Moving ahead in the state of lockdown, the overall impact on the economy became much more evident and it was clear that the majority of businesses were pushed to a state of significant financial distress, where the sustainability of cash flow and generation of profits was rendered extremely difficult and cause of tremendous worry. Adding constant salt to the injury, was the fact that the duration till when the pandemic would last was nowhere to be foreseeable, which had further created an immeasurable sense of helplessness within the stakeholders. In the prevailing circumstances, it was conceivable that the businesses might not be able to discharge debts expediently and defaults attracting invocation of provisions of the IBC would inevitably rise to massive proportions, which would push many businesses into insolvency. Furthermore, in the circumstances, the possibility of finding adequate resolution applicants to rescue the stressed businesses was also dim and it was inevitable that a huge number of corporates would end up under liquidation, which needless to say would cause irreparable damage to the economy of the nation. It is pertinent to remember that the objective of the IBC was never to liquidate or close companies but in fact to find an effective and balanced resolution, where a stressed company would be able to discharge the debts owed to its creditors and eventually overcome the adverse situation to realise its economic potential.

Therefore, in order to aid the distressed businesses in the extraordinary circumstances, the Hon'ble President of India on June 5, 2020, promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 which inserted section 10A in the IBC, by operation of which the rights of creditors to initiate CIRP against CDs under sections 7, 9 and 10 of the IBC with respect to defaults arising on or after March 25 , 2020 were suspended for a period of 6 months or such further period, not exceeding one year from March 25, 2020, as may be notified later.

Section 10A of the IBC is only operative in relation to defaults of debt payments that have occurred after March 25, 2020, and does not provide any protection of debtors who have defaulted in payment of liability that arose prior to the said 'cut-off' date. Therefore, the intention of the legislature was clear that sections 7, 9, and 10 remain absolutely in force for defaults, which have no connection and/or are not a direct result of the financial crisis, which emerged due to the COVID-19 pandemic. Therefore, it is pertinent to note that the creditors continue to exercise their right to approach the NCLT with applications for initiation of CIRP against CDs for debts that are in default before March 25, 2020, and such applications would not be barred on account of the operation of section 10A.

BEHAVIOURAL ECONOMICS IN POLICY

Behaviour Economics incorporates insights from psychology to economics in order to understand how humans behave rather than how they should behave - which has been the focus of neoclassical economic models. It adopts the widely used positive economics methodology promoted by Milton Friedman, who stated that evaluating economic models on the accuracy of their actual predictions rather than their assumptions is more beneficial.[1]

For the past few years, behavioural economics has been on the rise, owing to two factors: its effectiveness and its reach. One of the most oft-quoted examples of behavioural intervention is how in countries where individuals are 'default' organ donors, the average donor rate is 90%, whereas in countries where one has to actively enrol in the program, the donor rate averages just over 10%. These statistics reflect the default bias - how people favour the default option over actively choosing something.[2]

This example highlights how simple, inexpensive, and scalable interventions can have an exponential impact on society. Realising this, there are now more than 200 public entities all over the world applying behavioural insights to their policies. In the 2018-19 Economic Survey of India, an entire chapter was devoted to how behavioural science can be incorporated into policymaking.

Behavioural Aspects of the IBC

David Friedman in his book 'Law's Order: What Economics Has to Do with Law and Why It Matters' (2000) said, *'Legal rules are to be judged by the structure of incentives they establish and the consequences of people altering their behaviour in response to those incentives'.*

While law aims to enforce a specific type of behaviour in a community, economics, particularly behavioural economics, helps to explain how an economic agent chooses from a menu of options. The development of the law and economics movement developed a paradigm for the economic analysis of law. Theoretically, legal procedures are best analysed and comprehended in light of standard economic concepts, according to this approach to law.

Legislations designed appropriately and enforced efficiently can adequately incentivise economic agents to choose the most desirable or the most efficient outcome.

Taking note of the recent amendments to the IBC, the Economic Survey 2021-22 commented on the change of behaviour on the part of the debtors. It stated that distressed assets have a lifespan, and their value diminishes over time. Debtors' behaviour has changed as a result of the possibility of a CD changing hands. Thousands of debtors are resolving their financial distress at an early stage, either when the default is imminent, on receipt of a notice for repayment but before filing an application, after filing the application but before admission, and even after admission of the application, and making every effort to avoid the resolution process's consequences.

The Behavioural Insights Team (BIT) from the United Kingdom (UK) in 2014 created a framework to spread the understanding of behavioural approaches across the policy community. This framework, known as EAST (Easy, Attractive, Simple, Timely), is used to design policy interventions to improve outcomes as well as to assess the viability of interventions.

The IBC performs well when assessed through this framework. The IBC is a one-stop solution for resolving insolvencies, which was formerly a time-consuming process with no economically acceptable remedy.

It has also been able to simplify the process of resolving insolvency from the earlier regime by consolidating the earlier laws into a single legislation.

The IBC deems itself to be an attractive option. The IBC's principal goal, according to IBBI, is to help distressed CDs. Through resolution plans, the Code has, till June 2021, rescued 348 CDs (21% of completed CIRPs).

The debtors owed ₹ 5.67 lakh crore in total in 348 cases where the resolution plan was accepted. Creditors were able to recover ₹ 2.09 lakh crore from this (37%). A statistic to be noted is that when these 348 CDs entered CIRP, the value of their assets was barely ₹ 1.11 lakh crore, according to IBBI.[3]

The Code stipulates that CIRP must be completed within 180 days, with a 90 days extension possible. In 2019, the IBC was changed to mandate that the CIRP be completed in 330 days, including any extensions and time spent in judicial processes.

Credit markets, by their very nature, are affected by information asymmetry between the different parties involved, like creditors, debtors, employees, and the government. This suggests that one of the parties to the transaction has a better understanding of the underlying product and its dangers.

This results in adverse selection in terms of the rate of loan provided to the borrowers. Since creditors operate under incomplete information, the rate of lending does not correlate with the risk profile of the firm. Therefore, in the market, the relatively low rate appeals to the high-risk borrowers, who borrow happily, while the low-risk borrowers leave the market, as they cannot service the relatively high rate of borrowing, leaving a high-risk market behind.

Another issue to arise in this transaction is 'moral hazard,' which occurs when a debtor with superior information changes their behaviour after receiving credit, increasing their exposure to risk, while the creditor suffers the consequences of the debtor's new behaviour.

The IBC provides a choice architecture to the economic agents involved in the process in order to arrive at a more efficient outcome.

Choice architecture is a term coined by Thaler and Sunstein (2008) referring to the practice of influencing choice by 'organising the context in which people make decisions'.[4]

The Code provides stakeholders with convenient options in the form of a two-way solution. For starters, it gives them an automatic choice of resolution while also giving them the option to depart via a withdrawal mechanism. It also uses default preferences to maximise the welfare of stakeholders and society as a whole.

Another important behavioural principle utilised by the IBC is 'loss aversion'. In behavioural science, it has been found that 'losses loom larger than gains', i.e., the psychological pain of loss is twice as powerful as the pleasure of gaining something. Therefore, when the promoters of a firm are divested of their rights as soon as the CIRP is initiated, they try to resolve the process as soon as possible. To support this principle, it has been observed in multiple instances that CDs have paid the default amount after submitting a CIRP application or returned their obligations quickly after receiving notification from creditors in the past.

The IBC is still an evolving legislation, becoming more mature with each judgment of the Hon'ble Supreme Court, High Courts, NCLAT and NCLT. The purpose of introducing the IBC was to clear the NPAs and give a fresh boost to the Indian economy by eliminating the defaulters and giving opportunities to more efficient market players to employ the newly acquired assets for more productive value generation.

Under the IBC regime, efforts have been made to resolve the NPA issues by giving considerable relaxations to the new acquirers, creating a smooth environment to deal with the challenges of utilising new assets efficiently.

After the induction of the IBC, the lower default threshold allowed the unsecured creditors to proceed to NCLT in order to settle their payments, with defaults as low as ₹ 1 lakh being admitted. An increase in the threshold limit to ₹ 1 crore prevented such small defaults from being admitted in court.

In the past, debtors used the complicated insolvency ecosystem as a method to exploit the creditor. Since inability to pay was not defined under the Companies Act, 2013, there was no standard method to confirm whether the company was in a position to pay or not. The induction of the IBC brought about a massive change in the previous ecosystem and allowed creditors to approach the court to settle claims.

This however led to an exploitation of the lower threshold limit set by the Code and parties started initiating the CIRP even for petty claims, arm-twisting firms. This attitude however was changed once the threshold limit was increased from ₹ 1 lakh to ₹ 1 crore on March 24, 2020. The above-mentioned data is a testament to that.

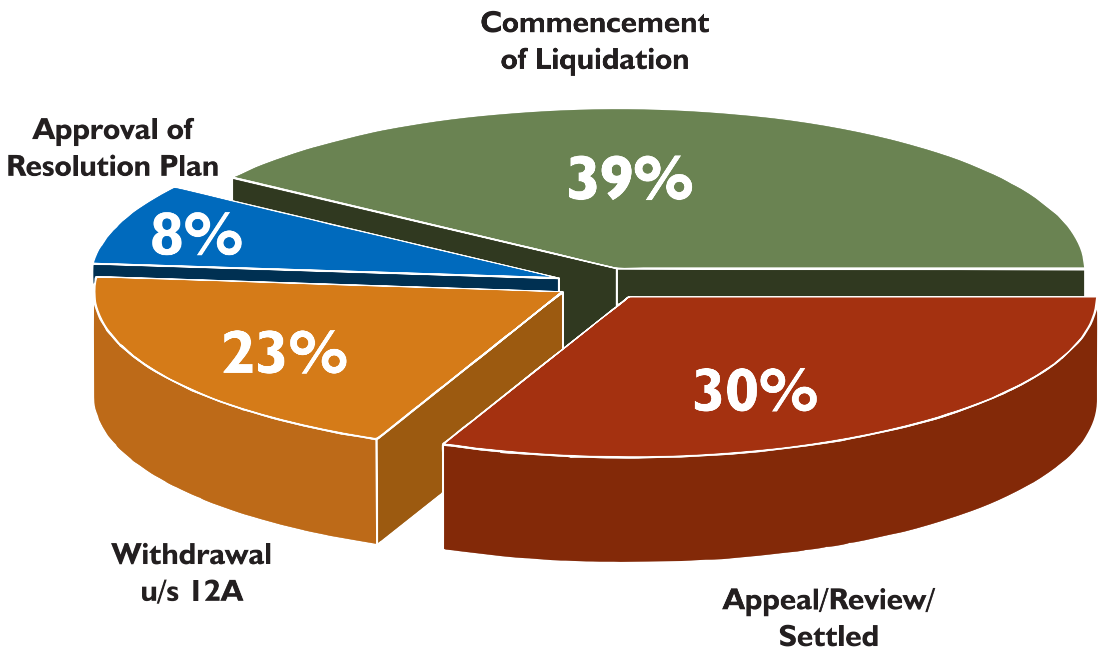

Fig. 1: *Distribution of Closed CIRPs - Initiated by OCs (Source: IBBI Quarterly Newsletter, October - December, 2021)*

In the first figure, we see that the withdrawals under section 12A of the IBC as well as the appeal/review/settlement together account for 53% of the closed CIRP. This clearly represents the fact that most parties prefer to settle their claims instead of going ahead with the liquidation of the company or accepting the insolvency resolution plan. A behavioural change can also be clearly observed in the above data amongst the operational creditors.

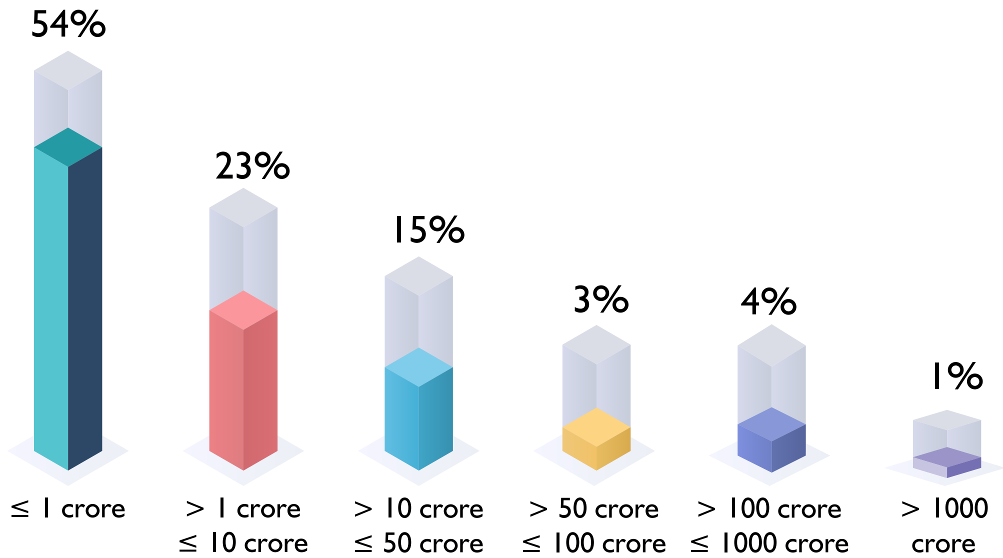

Fig. 2: *Distribution of CIRPs Withdrawn (as per Admitted Claims)*
(Source: IBBI Quarterly Newsletter, October - December, 2021)

In the second figure, one can witness the fact that 54% of the CIRP were withdrawn by the parties involved and those cases amounted to a default of less than or equal to ₹ 1 crore. It verifies a definite behavioural change brought about in situations wherein defaults by companies that were not in an actual insolvency state, were settled once the CIRP was started, and the debtor could potentially lose control of their firms.

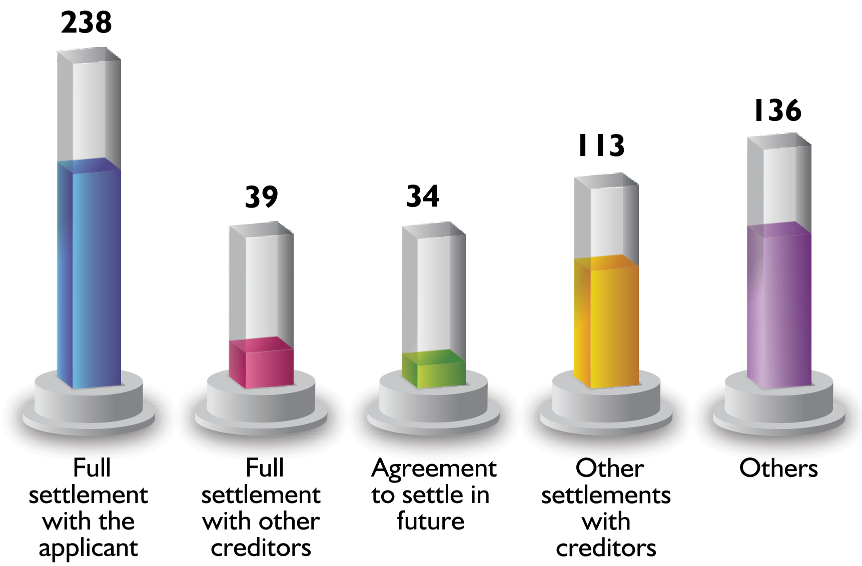

Fig. 3: *Reasons for Withdrawal of CIRPs (Source: IBBI Quarterly Newsletter, October - December, 2021)*

The third figure lists the various reasons for the withdrawal of CIRP under the IBC. It states that the major reason for such withdrawals can be amounted to the settlement of claims amongst the parties involved.

The above figure well indicates that with a lower default threshold, creditors, especially the operational creditors settled their claim, indicating that the borrower had the capacity to settle and initiation of CIRP acted like a nudge for them. The company was not in a true state of insolvency.

CONCLUSION

Indian lawmakers should seriously consider a behavioural economics approach to change creditors' behaviour and make them focus more on resolution than recovery. After all, the way courts are functioning in India compels us to look for solutions outside the judicial process.

The World Bank notes that courts and the judges often act as an impediment to the efficient resolution of insolvency.[5] Laws which trap businesses in lengthy court proceedings or impose penal provisions on bankruptcy muzzle risk-taking entrepreneurship.[6] The IBC was lauded for its time bound resolution process, but according to the IBBI, of the 4,500 cases that have been admitted, only 14% of cases have been resolved, 38% are still ongoing and 63% have been closed. Experts say that there has been destruction in the value of assets due to delays. This means that we must now look for solutions outside courts to make IBC successful. It might also be worth educating in lending morality and company turnaround. Story sharing about creditors who consider resolution over recovery, shifting incentives for banks towards resolution, abrogating disincentives in the form of a myopic regulatory audit that punishes banks for letting go of higher recovery in order to save a company, are few, to begin with.

Behavioural research offers the prospect of moving beyond focussing on poor outcomes and focussing more on where and why consumers make poor choices.[7] Non-payment of debt is like delinquencies that are costly for lenders as well as companies as well as other stakeholders. Recent research indicates that simple modifications of automated phone prompts provide an inexpensive way to propel good behaviour. This can be used well in retail insolvency such as credit card insolvency, where such nudge steps early even before the borrower defaults or shows likelihood of default.

Use of behavioural economics sheds light on the nature of borrowers as well as creditors issues with the loan market and how regulation might be used to address these issues. In doing so, it aims to illustrate the advantages, and the pitfalls, of applying behavioural economics to questions of regulatory reform. Like many other financial services, insolvency situations involve complex information, making choices over time and assessing risks, all factors which have been the focus of behavioural economics research.

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10

SALE OF CORPORATE DEBTOR AS A GOING CONCERN:

BOON OR BANE

— *Nipun Singhvi and Pragati Tiwari*

Executive Summary

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) has been introduced with the main objective of resolution/revival of the corporate debtor (CD) and maximisation of value of assets of the CD. The Insolvency and Bankruptcy Board of India (IBBI) on March 27, 2018 brought IBBI (Liquidation Process) (Amendment) Regulations, 2018 and introduced a sub-clause (c) in regulation 32, which allowed the Liquidator to sell the CD as a going concern and the said regulation was further amended on October 22, 2018. After the amendment, regulation 32 of the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations) provides various modes of sale of the CD during the liquidation period wherein regulation 32(e) and 32 (f) provides for the sale of CD as a going concern and sale of the business of the CD as a going concern respectively.

In order to achieve the goal of maximising the value of the assets of the CDs, the judiciary has introduced the concept of sale of the CD as a going concern. However, due to lack of specific provision for formal order of sale of CD as going concern and various necessary reliefs by Adjudicating Authority (AA), which could have guided the procedure in a most efficient manner, rather made it a craggy path for both purchaser as well as for stakeholders. Therefore, it requires legislative or judicial intervention to lay down the path for smooth process and functioning so that objectives of the Code can be achieved in a real sense.

Keywords: Going Concern, Corporate Debtor, Adjudicating Authority, Maximisation of Value, Successful Purchaser, Resolution Plan.

INTRODUCTION

Regulation 32 of the Liquidation Regulations initially provided four viable options for sale of CD in liquidation they are (a) that Liquidator may sell the assets of the CD on a standalone basis, (b) in a slump sale, (c) set of assets collectively or (d) assets in parcel. The main objectives of the Code is the resolution/revival of the CD and the maximisation of value of assets of the CD. The National Company Law Tribunal (NCLT) Kolkata bench in the judgment of *Gujarat NRE Coke Ltd.* dated January 11, 2018 stated that, in order to ensure the objectives of the Code, and to protect the employment of various workers, the bench directed the Liquidator to sell/dispose off the CD as a going concern and further directed that '*if the process of sale of CD as going concern failed during this period, then process of sale of the assets of the company will be according to the provisions of sale of assets of the Corporate Debtor prescribed under Section 33 of the Code'.*[1]Subsequently to remove this difficulty, the IBBI on March 27, 2018 notified the IBBI (Liquidation Process) (Amendment) Regulations, 2018 and introduced a new sub-clause (c) in regulation 32 of the Liquidation Regulations, which allowed the Liquidator to sell the CD as a going concern and the said regulation was further amended on October 22, 2018. After the amendment, regulation 32 of the Liquidation Regulations provides various modes of sale of the CD during the liquidation period wherein regulation 32(e) and 32(f) provides for the sale of CD as a going concern and sale of the business of the CD as a going concern respectively.

The Code does not define the term 'going concern'. However, the Insolvency Law Committee (ILC) in their report dated March 26, 2018, mentioned that the term 'as a going concern' implies that '*the Corporate Debtor would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the Code'.*[2]*.* The sale of a CD as a going concern was brought by the legislature to protect and ensure the ultimate aim and sacrosanct objective of the Code i.e. the maximisation of value of the assets of CD. However, due to the absence of specific or detailed provisions to carry out the sale, various difficulties are arising as successful bidders has to make the full payment within 90 days of the date of demand as per Schedule I (12) under regulation 33 of the Liquidation Regulations and after making the payment they have to run from post to pillars for getting relief(s) and concession(s) to get clean slate as provided in resolution plan under the corporate insolvency resolution process (CIRP).

MEANING OF THE TERM 'GOING CONCERN'

The concept of going concern is the fundamental principle used as the accounting term for a company that is financially stable enough to meet its duties, debts and obligations and can continue running its business operations in the foreseeable future. This term also indicates to a company's ability to operate enough in a manner so as to stand in the competitive market and to avoid bankruptcy. If the business is not a going concern or forced to discontinue its operations for any reason, it means it has gone bankrupt and its assets were liquidated[3].

In other words, the going concern concept is expected to fulfil these following things as under:

(a) The business is capable of running its operations on the daily basis having enough capital and the raw material[4].

(b) The business entity has the ability to pay off its debt during the accounting period[5].

(c) There should be a proper demand and supply chain required to be followed between the business and the market[6].

Moreover, a firm's inability to meet its obligations without substantial restructuring or selling of the assets are also indicative of the fact that firm is not a going concern. Other indicatives may include negative trends in operating results, continuous losses in the previous accounting years, inability to pay the operational debts to the creditors, loan defaults and various legal proceedings pending against the firm.

JURISPRUDENCE OF GOING CONCERN SALE

In the commentaries of UNCITRAL Legislative Guide on Insolvency Law as cited in the Bankruptcy Law Reforms Committee (BLRC) Report of November 2015, under the head 'Striking a balance between liquidation and reorganisation' it has been stated that:

> This is predicated on the basic economic theory that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments. To ensure that insolvency proceedings are not abused by either creditors or the debtor and that the procedure most appropriate to resolution of the debtor's financial difficulty is available, an insolvency law should also provide for conversion between the different types of proceedings in appropriate circumstances.[7]

CIRP under the Code aims at the revival of financially distressed company. Whereas, in terms of liquidation, the aim is the maximum recovery to the creditors because in liquidation the CD cease to exist as a corporate entity. However, the emerging jurisprudence in the Code due to various case laws and amendments thereto, it explores the possibility of revival even during the liquidation process, in the form of 'sale of the CD as a going concern' or 'going concern sale'.

The objective behind the introduction of the Code in India are as follows: -

(a) To consolidate and amend the laws relating to re-organisation and insolvency resolution of corporate persons, partnership firms, and individuals.[8]

(b) To fix time periods for execution of the law in a time-bound settlement of insolvency (i.e. 180 days).[9]

(c) To maximise the value of assets of interested persons.[10]

(d) To promote entrepreneurship.[11]

(e) To increase the availability of credit.[12]

(f) To balance all stakeholder's interest (including alteration). Balance to be done in the order of priority of payment of government dues.[13]

(g) To establish an Insolvency and Bankruptcy Board of India as a regulatory body for insolvency and bankruptcy law.[14]

(h) To establish higher levels of debt financing across a wide variety of debt instruments.[15]

(i) To provide painless revival mechanism for entities.[16]

(j) To deal with cross-border insolvency.[17]

(k) To resolve India's bad debt problem by creating a database of defaulters.[18]

Considering the same the Preamble of the Code states:

> An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government

> dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.[19]

Moreover, the objective of the Code can be traced in the BLRC Report of November 2015, under the head of 'speed is essence' as depicted below: -

> From the viewpoint of creditors, a good realisation can generally be obtained if the firm is sold as a going concern. Hence, when delays induce liquidation, there is value destruction. Further, even in liquidation, the realisation is lower when there are delays. Hence, delays cause value destruction. Thus, achieving a high recovery rate is primarily about identifying and combating the sources of delay.[20]

This extract from the BLRC report, in parallel reading with the afore stated Preamble of the Code; it can be inferred that liquidation is not the objective of the framers of the Code. The objective is the maximisation of the value of the assets of the CD. Thus it is imperative that if the liquidation is not yielding the objective of the Code to maximise the value of the assets then, if there's a possibility of having a prospective buyer of the CD, then it should be sold as a going concern. It can also be observed that liquidation as a going concern would strike a balance between dissolution and revival and is coherent with the objective of maximisation of the value of assets of the CD as well.

Also, this derivative can also be understood by analytical reading of one of the extract from 'Corporate Insolvency: Law and Practice' by Sumant Batra; which reads as follows: -

> A key objective of the insolvency law is to maximise the value of assets. Economical theories suggest that an enterprise should be reorganised, sold for cash as going concern, or closed down and liquidated piece-meal depending on which of the two techniques generates the greatest total value.[21]

In order to derive the meaning and interpretation of the term 'going concern' in relation to the Code, the following extract is necessary to understand the concept on prima facie level. The extract is as follows: -

> The phrase 'as a going concern' implies that the CD would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the Code.[22]

It is tacit that the term 'going concern sale' is well understood in legal parlance. The jurisprudence with this regard is fairly developed out of the erstwhile liquidation regime under the Companies Act, 1956. The Code however recognises 'going concern' and envisages resolution of the CD as a 'going concern' but does not define it under the Code. The ILC in their report dated March 26, 2018, noted that the phrase 'as a going concern' implies that the business affairs of the CD would be functional as it would have been prior to the initiation of CIRP, keeping parallel the other restrictions put by the Code. However, it may be explained that going concern means all such assets and the liabilities, which constitute an integral business or the CD, that must be transferred together, and that the consideration must be for carrying on the business or the CD.[23]

The acquirer (successful buyer) of the assets and liabilities should be able to run business without any disruption. The business or the CD must be a running one, and it must be transferred along with its employees. In case of sale of the CD as going concern, the equity shareholding of the CD must be transferred, and the buyer must take over the possession of the CD, its business, affairs and operations, including its licenses, beneficial interests, assets, entitlements, brand, trademarks, government approvals, etc.[24]

Going concern sale means selling of the CD on 'as is where is basis' that allows the Liquidator to sell the business of the CD company under liquidation as per the provisions of the Code. All the rights, titles, and interest in the CD including its legal entity is transferred to the successful purchaser. After the sale of the CD as a 'going concern', the successful purchaser will be carrying on the business operations of the CD. [25]

The ILC in their report dated March 26, 2018, examined the statutory compliances at various stages of CIRP to continue the CD as a 'going concern'. The excerpt of the report is depicted as follows:-

> 8.1. The provisions of the Code entrust the responsibility of managing the affairs of the corporate debtor as a going concern on the IRP and the RP. This involves meeting various statutory compliance requirements for which the management of the corporate debtor was responsible prior to commencement of the CIRP such as filing of financial statements, maintaining board's reports, appointment of auditor, etc. It may also involve informing the Registrar of Companies that a corporate debtor is going through a CIRP. The phrase '**as a going concern**' imply that the corporate debtor would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the Code.[26]

PROVISIONS UNDER THE CODE FOR GOING CONCERN SALE

Clause (f) of section 35(1) of the Code provides power to the Liquidator to sell the property of the CD in liquidation through the public auction or by private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels. Clause (f) of section 35(1) is reproduced here:[27]

> **Section 35: Powers and duties of liquidator.**
>
> (1) Subject to the directions of the Adjudicating Authority, the liquidator shall have the following powers and duties, namely:—
>
> (f) subject to section 52, to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as may be specified;
>
> Provided that the liquidator shall not sell the immovable and movable property or actionable claims of the corporate debtor in liquidation to any person who is not eligible to be a resolution applicant.[28]

The Liquidation Regulations envisage sale of the CD as a going concern under its regulation 32. It provides option to the Liquidator to sell the CD as a going concern or the business(s) of the CD as a going concern. Regulation 32 of the Liquidation Regulations[29] reads as under:-

> **32. Sale of Assets, etc.**
>
> The liquidator may sell-
>
> (a) an asset on a standalone basis;
>
> (b) the assets in a slump sale;
>
> (c) a set of assets collectively;

(d) the assets in parcels;

(e) the corporate debtor as a going concern; or

(f) the business(s) of the corporate debtor as a going concern:

Provided that where an asset is subject to security interest, it shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate.[30]

Difference between regulation 32(e) & 32(f)

Sale of CD as a going concern under regulation 32(e) and sale of business of CD as a going concern under regulation 32(f) are different.

Sale under regulation 32(e) – Sale of the CD as a going concern: In this form of going concern sale, the CD will not get dissolved. It will form a part of liquidation estate. It will be transferred along with the business, assets, and liabilities, including all contracts, licenses, concessions, agreements, benefits, privileges, rights, or interests to the successful buyer (acquirer). Moreover, the consideration received from the sale will be split into share capital and liabilities, based on a capital structure that the acquirer decides. There will be an issuance of shares by the CD being sold to the extent of the share capital. The existing shares of the CD will not be transferred and shall be extinguished. The existing shareholders will become claimants from liquidation proceeds under section 53 of the Code.[31]

Sale under regulation 32(f) – Sale of the business(s) of the CD as a going concern*:* The business(s) of the CD along with assets and liabilities, including intangibles, will be transferred as a going concern to the successful purchaser (acquirer), without transfer of the CD, and therefore, the CD will be dissolved. The existing shares will be extinguished. The remaining assets, other than those sold as part of business will be sold and the proceeds thereof will be used to meet the claims under section 53 of the Code.[32]

How the Option for Going Concern Sale can be Exercised?

The IBBI (Liquidation Process) (Amendment) Regulations, 2019 has inserted regulation 32A w.e.f. July 25, 2019, which states that the stakeholders as well as the Liquidator of the CD may exercise the going concern sale option as: -

(a) Where the committee of creditors (CoC) has recommended the sale under clause (e) or (f) of regulation 32 or where the Liquidator is of the view that the sale under clause (e) or (f) of regulation 32 shall maximise the value of the CD, he shall endeavour to first sell under the said clauses.[33]

(b) For this purpose the group of assets and liabilities of the CD, as identified by the CoC under regulation 39C(2) of the IBBI (Corporate Insolvency Resolution Process) Regulations, 2016 (CIRP Regulations), the Liquidator shall identify and group the assets and liabilities which are to be sold to the prospective buyer as a going concern, in consultation with the consultation committee.[34]

(c) If the Liquidator is unable to sell the CD or its business as prescribed under clause (e) or (f) of regulation 32, within the period of 90 days from the date of commencement of liquidation of the CD, he shall proceed to sell the assets of the CD under clauses (a) to (d) of regulation 32.[35]

Further, the IBBI (Corporate Insolvency Resolution Process) (Second Amendment) Regulations, 2019 w.e.f. July 25, has inserted regulation 39C which provides that CoC during CIRP recommend for the sale of the CD as a going concern and collate all assets and liabilities of the CD, it read as :-

39C. Assessment of sale as a going concern.

(1) While approving a resolution plan under section 30 or deciding to liquidate the corporate debtor under section 33, the committee may recommend that the liquidator may first explore sale of the corporate debtor as a going concern under clause (e) of regulation 32 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 or sale of the business of the corporate debtor as a going concern under clause (f) thereof, if an order for liquidation is passed under section 33.[36]

(2) Where the committee recommends sale as a going concern, it shall identify and group the assets and liabilities, which according to its commercial considerations, ought to be sold as a going concern under clause (e) or clause (f) of regulation 32 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.[37]

(3) The resolution professional shall submit the recommendation of the committee under sub-regulations (1) and (2) to the Adjudicating Authority while filing the approval or decision of the committee under section 30 or 33, as the case may be.[38]

Requisites of a Going Concern Sale

The below mentioned are the pre-requisites or the conditions for going concern sale.

(a) CD should be a going concern: The CD that is going to be transferred to successful bidder should be in running condition. Running condition does not mean that it should be a profit-making company or a flourishing company but it should be functional. A company which is not functional or stopped its function way back, was nevertheless transferred as a going concern.[39]

(b) Legal entity will continue: In case of sale of CD as a going concern in liquidation, the existence of legal entity of the company will continue and is transferred to the successful buyer/purchaser. It means that along with the transfer of undertaking all contracts, licences, concessions, agreements, benefits, privileges, rights, or interests will transfer subject to the approval of reliefs and concession by the AA or otherwise. However, in case of sale of a business of the CD as a going concern, legal entity of the CD gets dissolved, and it is only the business of the CD that transfers.[40]

(c) Contribution of successful purchaser in capital: In going concern sale of CD, the existing share capital or existing shares are extinguished, and existing shareholders will become the claimants of the CD and they will get as per waterfall mechanism provided under section 53 of the Code. After confirmation of sale successful purchaser will decide the capital structure of the CD and depend on the capital structure, there will be an issuance of the new shares by the legal entity to the extent of the decided share capital. However, in case of sale of business as a going concern the shares of the entity are extinguished and there will be no further issuance of share capital as the legal entity of the CD gets dissolved.[41]

(d) Retention of employees: In case of going concern sale of the CD in liquidation, employees of the CD do not get transferred as liquidation order is deemed to be a notice of discharge of employees and employees receive their pending dues as per section 53 of the Code. However, if successful purchaser wants to retain the employees of the CD he may negotiate terms and conditions of employment.[42]

(e) Security Interest on assets: In going concern sale of CD in liquidation where the security interest is relinquished by the secured creditors, the assets of the CD are transferred to the successful purchaser without any encumbrance as secured creditor will receive payment against their dues as per waterfall mechanism provided under section 53 of the Code.[43]

(f) Transfer of whole assets: During sale of CD as a going concern in liquidation, the entire undertaking along with all the assets of the CD transfers to the successful purchaser and purchaser has to pay the consideration for whole entity not for individual assets.[44]

(g) Closure of the Liquidation Process: In case where CD is sold as a going concern, the CD does not get dissolved formally instead after distribution of the proceeds as per section 53 of the Code, liquidation process of the CD closes by the order of the Hon'ble AA.[45]

(h) Transfer of liabilities: All the liabilities of the CD shall be settled out of the realised amount from the sale of the CD as a going concern as per section 53 of the Code.[46]

(i) Purchaser intends to run the business: In sale as a going concern the intention of the successful purchaser is to run the CD or a concern and if concern is a closed company, then it cannot be sale a going concern. Therefore, the intention of the purchaser in going concern sale is always to run the concern.[47]

JUDICIAL PRONOUNCEMENTS ON SALE AS A GOING CONCERN

Gujarat NRE Coke Limited, NCLT Kolkata bench (January 11, 2018)[48]

Initially there was no specific provision under the Code for sale of a CD as a going concern. However, absence of provision could not restrain Hon'ble NCLT Kolkata to protect the existence of CD and to save the bread and butter of number of employees. It directed Liquidator of Gujarat NRE Coke under regulation 32(b)(i) of the Liquidation Regulations to dispose off CD as a going concern. Later on, legislature took cue from the judicial creativity and to remove the difficulty brought amendment in Liquidation Regulations allowing the Liquidator to sell the CD as a going concern.

M/s. Visisth Services Limited v. S. V. Ramani & Ors. NCLAT (January11, 2022)[49]

An appeal was filed against the order of Hon'ble NCLT Kolkata order dated August 7, 2020 wherein Hon'ble AA directed the Liquidator that if successful purchaser of the CD as a going concern will pay full amount, Liquidator shall execute a sale deed and if purchaser fails to pay the balance sale consideration then Liquidator is at liberty to forfeit the earnest money deposit (**EMD**) and cancel the sale. Successful purchaser challenged the said order before Hon'ble National Company Law Appellate Tribunal (NCLAT) on the ground that the terms and conditions of the bid documents are not absolute and bid document is only an intimation to offer and proposed purchaser has right to negotiate upon the terms subject to which the offer will be made.

Hon'ble NCLAT upheld the order of AA and held that Liquidator shall make efforts to sell CD as a going concern as per law and if the purchaser is allowed to withdraw from the bid and EMD is refunded then the liquidation process will become never ending process and time is the very essence of the process under the Code. Therefore, as laid down by Hon'ble Supreme Court in plethora of judgments that once the bid is accepted by the bidder, he/she cannot wriggle out from the contractual obligations arising out of the bid. Therefore, if purchaser does not act as per the terms of the contract then Liquidator has liberty to forfeit the EMD or amount paid towards the bid purchase documents.[50]

Shiv Shakti Inter Globe Exports Pvt. Ltd. v. M/s KTC Foods Private Limited & Ors. NCLAT (February 25, 2022)[51]

Appellant filed an appeal against the order dated May 18, 2020 passed by Hon'ble NCLT Chandigarh bench in CA No. 1189 of 2019 in CP(IB) No. 136 of 2018. The AA partially allowed the application and denied the sale of the CD as a going concern without any contingent and other liabilities and denied the immunity from the existing litigations. The said order was challenged before Hon'ble NCLAT by the successful purchaser/ bidder and Hon'ble NCLAT modified the order of AA and held that it is a settled proposition held in catena of judgments that successful bidder of the CD as a going concern in liquidation should not be burdened with past liabilities. Therefore, while confirming sale of the CD as a going concern in liquidation it is necessary to ensure that CD should not be burdened with the past liabilities therefore, all the past/ remaining liabilities including contingent liabilities shall stand extinguished.

Nimmagadda Surya Pradeep Bio-Tech Pvt. Ltd. v. Kamineni Steel and Power India Pvt Ltd, NCLT Hyderabad bench [52]

Successful bidder filed an application before AA seeking extension of time duration to pay the balance consideration amount to the Liquidator. AA observed that sale as a going concern is always a better resolution of the CD than permitting part sale and granted final chance to the successful purchaser to pay bid amount within the extended time limit.

RELIEFS AND CONCESSIONS: DISCRETION OF ADJUDICATING AUTHORITY

As per regulation 39C of the CIRP Regulations, during CIRP, if CoC recommends for the sale of CD as a going concern in liquidation, then CoC has to identify and group the assets and liabilities of the CD which requires to be sold as a going concern. Hence, in a going concern sale of CD as per regulation 32A of Liquidation Regulations, the company as a whole becomes a part of the liquidation estate and transfer on an 'as is where is' basis.[53]

During going concern sale of a CD whole company along with its identity gets transferred therefore, it is more likely in the nature of resolution of the CD and herein also successful bidder wants clean slate to run the business as a going concern and purchasing a debt ridden company with all its assets and liabilities can never revive the CD and even the cycle of default will continue. Therefore, it is necessary to provide certain reliefs and concessions to successful bidder also in going concern sale as provided by the AA during approval of resolution plan. Even Hon'ble NCLT Hyderabad in *Southern Online Bio-Technologies Ltd.* granted reliefs and concessions to successful bidder and observed that regulation 32 enables Liquidator to sell CD as a going concern and the main object of the Code is the resolution of the CD, not the liquidation and selling of a CD is more in the nature of resolution of the CD therefore, mere sale of a CD without granting certain reliefs and concessions which are necessary to run the CD is of no use.[54] Even other NCLT benches also granted certain reliefs and concessions in going concern sale of CD, some of the reliefs that are granted is summarised below in Table 1.

Table 1: Reliefs granted in going concern sale of CD

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
		First Category of Reliefs			
		All licenses, consents, approvals, benefits, rights, entitlements and privileges will transfer	Past liability or demands payable by the past management shall be considered as settled	Existing shares of the CD shall stand extinguished	Successful bidder shall be allotted 100% shareholding of the CD
	Nitin Jain Liquidator of PSL Limited v. Lucky Holdings Pvt. Ltd. IA 391 (AHM) 2021 IN CP (IB) 37 of 2017	Para 7 (m) Page No. 64	Para 7 (n) Page No. 65	Para 7 (b) Page No. 59	
	Profitplus Infra Pvt. Ltd. v. Pradeep Kumar Kabra Liquidator of Pacific Pipes Systems Pvt. Ltd. IA 411 (AHM) 2021 IN CP 305 of 2018	Para 10 (VII.) Page No. 13	Para 10 (IV.) Page No. 12 Para 10 (V.) Page No. 13		
	Gaurav Jain v. Sanjay Gupta, Liquidator of Topworth Pipes and Tubes Pvt. Ltd. IA 2264 of 2020 in C.P. 1239/ MB/2018	Para 34 (b) Page No. 21 Para 34 (j) Page No. 23	Para 34 (c) Page No. 21	Para 34 (e) Page No. 22	

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
First Category of Reliefs					
	Dr. Devaiah Pagidipati v. Southern Online Bio Technologies Limited IA 1038 of 2019 in C.P. 343/7/HDB/2018	Para 16 Page No. 11	Para 17 Page No. 11	Para 19 Page No. 12	Para 20 Page No. 12
	Mr. T. Raja Kishore v. TSN Raja, Liquidator of M/s VNR Infrastructures Limited IA 397/2021 in CP 12/10/HDB/2017	Para 10 Page No. 12	Para 11 Page No. 12	Para 9 Page No. 12	
	Gland Celsus Bio Chemicals Private Limited v. KSK Energy Ventures Limited I.A 112 of 2021 CP 675/7/HDB of 2018	Para 3 Page No. 12 Para 6 Page No.13	Para 4 Page No. 12 Para 10. Page No. 13	Para 1 (b) Page No. 11	Para 1 (a) Page No. 11
	M/s Elecon Engineering Company Ltd v. Ms Enviiro Bulkk Handling Systems Pvt Ltd I.A 741 of 2021 in C.P 1319/MB/2017	Para II. (h) Page No. 17 Para II. (i) Page No. 17	Para II. (c) Page No. 16	Para II. (e) Page No. 17	

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
			Second Category of Reliefs		
		Existing directors shall vacate the office	ROC shall change status to 'active'	CD allowed to review and terminate the contracts	Exemption of CD from payment of registration fees, stamp duty and other taxes
	Nitin Jain Liquidator of PSL Limited v. Lucky Holdings Pvt. Ltd. IA 391 (AHM) 2021 IN CP (IB) 37 of 2017	Para 7 (c) Page No. 59	Para 7 (d) Page No. 59	Para 7 (i) Pg. No. 62	
	Profitplus Infra Pvt. Ltd. v. Pradeep Kumar Kabra Liquidator of Pacific Pipes Systems Pvt. Ltd. IA 411 (AHM) 2021 IN CP 305 of 2018	Para 10 (II.) Page No. 12	Para 10 (I.) Page No. 12	Para 10 (VIII.) Page No. 14	
	Gaurav Jain v. Sanjay Gupta, Liquidator of Topworth Pipes and Tubes Pvt. Ltd. IA 2264 of 2020 in C.P. 1239/ MB/2018	Para 34 (f) Page No. 22	Para 34 (e) Page No. 22	Para 34 (h) Page No. 22	

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
Second Category of Reliefs					
	Dr. Devaiah Pagidipati v. Southern Online Bio Technologies Limited IA 1038 of 2019 in C.P. 343/7/HDB/2018	Para 20 Page No. 12			
	Mr. T. Raja Kishore v. TSN Raja, Liquidator of M/s VNR Infrastructures Limited IA 397/2021 in CP 12/10/HDB/2017	Para 9 Page No. 12	Para 13 Page No. 13	Para 14 Pg. No. 13	Para 13 Page No. 13
	Gland Celsus Bio Chemicals Private Limited v. KSK Energy Ventures Limited I.A 112 of 2021 CP 675/7/HDB of 2018			Para 7 Page No. 13	
	M/s. Elecon Engineering Company Ltd v. Ms Enviiro Bulkk Handling Systems Pvt Ltd I.A 741 of 2021 in C.P 1319/MB/2017	Para II. (g) Page No. 17	Para (f) Page No. 17	Para II. (j) Page No. 17	

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
Third Category of Reliefs					
		All assets of the company shall vest with successful bidder	Quash all the related party transactions entered by CD	The successful bidder shall be allowed to use all the patents, TM and intangible assets	Documents taken as charge be returned back to the CD. All charges due in ROC shall stand cancelled.
	Nitin Jain Liquidator of *PSL Limited v. Lucky Holdings Pvt. Ltd.* IA 391 (AHM) 2021 IN CP (IB) 37 of 2017	Para 7 (k)			Para 7 (f) Page No. 60
	Profitplus Infra Pvt. Ltd. v. Pradeep Kumar Kabra Liquidator of Pacific Pipes Systems Pvt. Ltd. IA 411 (AHM) 2021 IN CP 305 of 2018				Para 10 (VI.) Page No. 13
	Gaurav Jain v. Sanjay Gupta, Liquidator of Topworth Pipes and Tubes Pvt. Ltd. IA 2264 of 2020 in C.P. 1239/ MB/2018	Para 34 (h) Page No. 22 Para 34 (m) Page No. 23			

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
	Third Category of Reliefs				
	Dr. Devaiah Pagidipati v. Southern Online Bio Technologies Limited IA 1038 of 2019 in C.P. 343/7/HDB/2018				
	Mr. T. Raja Kishore v. TSN Raja, Liquidator of M/s VNR Infrastructures Limited IA 397/2021 in CP 12/10/HDB/2017	Para 16 Page No. 13			
	Gland Celsus Bio Chemicals Private Limited v. KSK Energy Ventures Limited I.A 112 of 2021 CP 675/7/HDB of 2018			Para 8 Page No. 13	
	M/s. Elecon Engineering Company Ltd v. Ms Enviiro Bulkk Handling Systems Pvt Ltd I.A 741 of 2021 in C.P 1319/MB/2017	Para II. (l) Page No. 17			

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
Fourth Category of Reliefs					
		Govt. authority shall waive tax, interest of penalties and shall not initiate penal proceedings in case of on-fulfilment of any obligation	Waiver from the requirement of obtaining a no objection certificate	Waiver from the requirement of obtaining valuation report on issuance of new equity shares	Govt. authority shall waive of all the non-compliances, breach and defaults of the company prior to the order
	Nitin Jain Liquidator of PSL Limited v. Lucky Holdings Pvt. Ltd. IA 391 (AHM) 2021 IN CP (IB) 37 of 2017				Para 7 (l) Page No. 64
	Profitplus Infra Pvt. Ltd. v. Pradeep Kumar Kabra Liquidator of *Pacific Pipes Systems Pvt. Ltd.* IA 411 (AHM) 2021 IN CP 305 of 2018				Para 10 (III.) Page No. 12
	Gaurav Jain v. Sanjay Gupta, Liquidator of Topworth Pipes and Tubes Pvt. Ltd. IA 2264 of 2020 in C.P. 1239/ MB/2018				Para 34 (k) Page No. 23 Para 34 (l) Page No. 23

Sl. No.	Name of Judgment	Relief	Relief	Relief	Relief
Fourth Category of Reliefs					
	Dr. Devaiah Pagidipati v. Southern Online Bio Technologies Limited IA 1038 of 2019 in C.P. 343/7/HDB/2018				
	Mr. T. Raja Kishore v. TSN Raja, Liquidator of M/s VNR Infrastructures Limited IA 397/2021 in CP 12/10/HDB/2017	Para 11 Page No. 12			
	Gland Celsus Bio Chemicals Private Limited v. KSK Energy Ventures Limited I.A 112 of 2021 CP 675/7/HDB of 2018				Para 15 Page No. 14
	M/s. Elecon Engineering Company Ltd v. Ms Enviiro Bulkk Handling Systems Pvt. Ltd. I.A 741 of 2021 in C.P 1319/MB/2017				

Sl. No.	Name of Judgment	Relief	Relief	Relief
Fifth Category of Reliefs				
		All inquiries, investigations (civil/criminal) in connection with the company shall stand withdrawn	The company's name will be removed from the 'Denied Entity List' by DGFT	Company shall be given benefit of section 79 of Income Tax Act, 1961 for carry forward of business losses and unabsorbed depreciation
	Nitin Jain Liquidator of PSL Limited v. Lucky Holdings Pvt. Ltd. IA 391 (AHM) 2021 IN CP (IB) 37 of 2017			
	Profitplus Infra Pvt. Ltd. v. Pradeep Kumar Kabra Liquidator of Pacific Pipes Systems Pvt. Ltd. IA 411 (AHM) 2021 IN CP 305 of 2018			
	Gaurav Jain v. Sanjay Gupta, Liquidator of Topworth Pipes and Tubes Pvt. Ltd. IA 2264 of 2020 in C.P. 1239/ MB/2018	Para 34 (d) Page No. 21 Para 34 (i) Page No. 22		Para 34 (q) Page No. 24

Sl. No.	Name of Judgment	Relief	Relief	Relief
Fifth Category of Reliefs				
	Dr. Devaiah Pagidipati v. Southern Online Bio Technologies Limited IA 1038 of 2019 in C.P. 343/7/ HDB/2018			
	Mr. T. Raja Kishore v. TSN Raja, Liquidator of M/s VNR Infrastructures Limited IA 397/2021 in CP 12/10/HDB/2017	Para 12 Page No. 13		
	Gland Celsus Bio Chemicals Private Limited v. KSK Energy Ventures Limited I.A 112 of 2021 CP 675/7/HDB of 2018	Para 5 Page No.12		Para 12 Page No. 13
	M/s. Elecon Engineering Company Ltd v. Ms Enviiro Bulkk Handling Systems Pvt. Ltd. I.A 741 of 2021 in C.P 1319/ MB/2017	Para II. (d) Page No. 16		

Contrary to this, Hon'ble NCLT Ahmedabad bench took an opposite view in the matter of *Sachin Bhandari v. Osaka Pharmaceuticals Pvt. Ltd.* dated January 21, 2021 and rejected the application of successful bidder seeking certain reliefs and concession, on the ground of maintainability, however liberty was given to Liquidator for filing appropriate application.[55] Therefore, because of lack of any specific provision successful bidders are posed with uncertainty of AA discretion to grant clean slate.

APPLICABILITY OF SECTION 29A IN SALE AS A GOING CONCERN

Section 29A of the Code provides the category of persons who are not eligible to submit a resolution plan and cannot be a resolution applicant (RA). Section 29A was inserted in the Code through Insolvency and Bankruptcy Code (Amendment) Act, 2018 with retrospective effect. The main objective to bring section 29A in the Code is to prevent the CD to go into the hands of the defaulters or to ensure that the Code is not misused by the promoters to get back door entry in the freshly resolved CD. The list of disqualifications under section 29A from clause (a) to (j) are as follows:

(a) a person who is an undischarged insolvent;[56]

(b) a person who is a willful defaulter as per the guidelines of the Reserve Bank of India (RBI);[57]

(c) a person with an account that has been classified as a non-performing asset (NPA) or is a promoter of the CD whose account has been classified as an NPA or is in management of such CD or is in control of such CD.[58]

This provision requires that the account should have been classified as an NPA at least for a duration of one year preceding the initiation of insolvency resolution process. A person disqualified under this provision would become eligible upon clearing all the outstanding dues with interest prior to submission of a resolution plan;[59]

(d) a person who has been convicted of an offence punishable with imprisonment for a period of two years or more;[60]

(e) a person who is disqualified from being a director in accordance with the Companies Act of 2013;[61]

(f) a person who has been prohibited by the Securities and Exchange Board of India from trading in securities or accessing the stock markets;[62]

(g) a person who is a promoter or is management of a CD which has been adjudicated to have carried out a transaction which is preferential or undervalued or extortionate or fraudulent;[63]

(h) a person who has issued a personal guarantee for the CD to the specific creditor whose application under the Code against the CD has been admitted and such guarantee remains unpaid;[64]

(i) a person subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or[65]

(j) a person who has a connected person not eligible under clauses (a) to (i) above.[66]

Therefore, section 29A of the Code imposes four layers of ineligibility which are mentioned below:

(a) Person ineligible.

(b) Person connected to ineligible person is ineligible.

(c) Person related to ineligible person is ineligible.

(d) Person acting jointly with or in concert with ineligible person.

Section 29A disqualifies certain category of persons to be a RA or to submit resolution plan but, it does not talk about successful bidder or purchaser of CD as a going concern in liquidation however, section 35(1)(f) proviso of the Code extends the applicability of section 29A ineligibility in sale of the assets of the CD in liquidation also. It read as, *'Provided that the liquidator shall not sell the immovable and movable property or actionable claims of the corporate debtor in liquidation to any person who is not eligible to be a RA.'*[67]

Even Hon'ble Apex Court in *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr.* (dated March 15, 2021) to remove the difficulty of application of section 29A of the Code in liquidation process, analyse the provisions of the Code and held that restriction imposed by the legislature by inserting section 29A and section 35(1)(f) in the Code is also extended to a scheme of compromise and arrangement under section 230 of the Companies Act, 2013 proposed in liquidation of the CD.[68]

SALE AS A GOING CONCERN Vs. RESOLUTION PLAN

(a) Approval by CoC: As per the Code, it is the duty of the Resolution Professional (RP) to put all the proposed resolution plans received by RP during CIRP before CoC for their consideration and voting and CoC has power to approve any resolution plan with a vote of not less than 66% of the voting rights as per their commercial wisdom. Even AA does not have power to question the commercial wisdom of the CoC. Hence, selection/ approval of a resolution plan is the domain of CoC, and RP and AA has very limited role. However, in sale of CD as a going concern in liquidation, creditors does not have much role to play, it is the Liquidator who sells CD as a whole in e-auction and decides successful bidder according to highest bid.[69]

(b) Round of negotiations: RP after receiving proposed resolution plans place them before CoC members, and call proposed and eligible RAs to explain their plan. CoC members discuss and negotiate with the proposed RAs and if possible, RA modify their plans as per suggestions/ demand of CoC members. In going concern sale of CD during liquidation, bidders cannot negotiate or put their terms and conditions with stakeholders or Liquidator. Successful bidder has to provide the whole consideration as per bid document and CD gets transferred to successful purchaser on 'as is where is basis'.[70]

(c) Timeline: The Code provides timeline for the completion of CIRP but it does not provide that RA should pay all the proposed amount within any timeline and RAs has liberty to propose a timeline of payment in their resolution plan however, once the plan is approved by AA, RA has to abide by the proposed timeline. In going concern sale of CD, timeline is provided under Schedule I of Liquidation Regulations and it provides that successful bidder has to pay full consideration within 90 days from the date of the close of the auction when Liquidator raise demand for balance sale consideration.[71]

(d) Effect of non-implementation: Once the resolution plan is approved by AA, it becomes binding on successful RA as well as on all the stakeholders of the CD. If successful RA violates or fails to implement the approved resolution plan, it is deemed as a civil contempt of the order of AA and even AA can take action under section 74(3) of the Code. However, in case of sale as a going concern, if successful purchaser/ bidder fails to pay balance sale consideration then Liquidator can forfeit EMD and can cancel the sale.[72]

DIFFERENT MODE OF SALE DURING LIQUIDATION, COMPARATIVE ANALYSIS

(a) Piecemeal/Standalone sale: When there are assets or class of assets which are not similar therefore, cannot be sold together or club together, then Liquidator can sell those assets individually piece by piece, separately in different auctions. Sometimes even when Liquidator sells the business of the CD as a going concern there may be a some of the scraps/assets which needs to sell separately.[73]

(b) Slump sale: In slump sale instead of assigning value to individual assets, a lump sum amount is assigned to collective assets of the CD. Slump sale is defined under section 2(42C) of the Income Tax Act, 1961 as, '*it means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales*'.[74] The following are the features of slump:

- Assets of the CD are sold collectively as a whole;[75]
- Assets are sold on lump-sum consideration;[76] and
- Item- wise value of the assets transferred are not assigned.[77]

(c) Sale of CD as a going Concern: CD will get transferred as a whole along with the business, assets and liabilities, including all contracts, licenses, concessions, agreements, benefits, privileges, rights or interests to the successful buyer (acquirer).[78]

(d) Sale of the business(s) of the CD as a going concern: The business(s) of the CD along with assets and liabilities, including intangibles, will be transferred as a going concern to the successful purchaser (acquirer), without transfer of the CD, and therefore, the CD will be dissolved. Assets of the CD can be classified into business assets and non-business assets. Liquidator can sell business assets as a whole to the purchaser as a going concern and can sell non business assets separately.[79]

Table 2: Types of Transfer

Types of sale	Transfer	Equity shareholding	Retention of employees	Existence of legal entity
Piecemeal sale	One or more assets of the CD transfers by assigning value individually to each and every asset.	Equity shareholding gets extinguished.	Liquidation order is deemed to be discharge of employees.	Once the assets are sold, CD gets dissolved
Slump sale	Assets of the CD gets transferred as a whole by assigning collective value.	Equity shareholding gets extinguished.	Liquidation order is deemed to be discharge of employees.	Once the assets are sold, CD gets dissolved.
Sale of CD as a going concern	Whole entity gets transferred.	Equity shareholding gets transferred	Liquidation order is deemed to be discharge of employees but for smooth functioning, purchaser can retain employees	Legal identity of CD survives as CD as a whole gets transferred.
Sale of CD business as a going concern	One or more business of the CD gets transferred.	Equity shareholding gets extinguished.	Liquidation order is deemed to be discharge of employees but for smooth functioning, purchaser can retain employees.	Once the business is transferred and all the assets are sold, CD gets dissolved.

CLOSURE OF LIQUIDATION PROCESS Vs. DISSOLUTION

Hon'ble NCLT Principal Bench, at Delhi in its order dated September 16, 2020 took a very interesting view in *Mohan Gems case* (I.A. No. 1490 of 2020 in CP(IB) No. 590(PB)/2018) in which an application was filed by the Liquidator seeking closure of the liquidation process under regulation 45(3)(a) of Liquidation Regulations as the CD was sold as a going concern in e-auction and Liquidator already distributed the realised amount among the stakeholders as per section 53 of the code. Hon'ble NCLT Principal Bench dismissed the application as misconceived and observed that regulation 39C of the CIRP Regulations which provides that CoC may recommend that if CD goes into liquidation, Liquidator first try to explore the sale of CD as a going concern or to sell the business of CD as a going concern and regulation 45(3)(a) of Liquidation Regulations which provides that where a CD is sold as a going concern Liquidator file the application for the closure of the liquidation process of the CD. Hon'ble NCLT Principal Bench observed that these two regulations (a) regulation 39C of the CIRP Regulations and (b) regulation 45(3)(a) of the Liquidation Regulations brought altogether a new concept and that are not backed up by any provision of law under the Code and does not have any merits as IBBI, the regulating authority cannot go beyond its power or jurisdiction.[80]

Hon'ble NCLT Principal bench further observed that the assets of the CD can be liquidated however, CD cannot be construed as an asset to be sold and dissolution shall not be dispensed with the closure of liquidation process therefore, as without dissolving a company as per section 54 of the Code, liquidation process cannot be closed under regulation 45(3)(a) of the Liquidation Regulations, hence regulation 45(3)(a) and 32A of the Liquidation Regulations are repugnant to section 54 of the Code.[81]

The above discussed order of Hon'ble NCLT Principal Bench, New Delhi was challenged before Hon'ble NCLAT in company appeal (AT) (Insolvency) No. 849 of 2020 and Hon'ble NCLAT set aside the order dated September 16, 2020 of Hon'ble Principle bench on the grounds that it is a settled position that NCLT or NCLAT cannot looked into the validity or legality of any regulation/rules/notification/Act, etc. The NCLT or NCLAT can has power or authority to check whether the prescribed procedure has been followed or not. The AA travelled far from its jurisdiction by making observation on the power of regulating authority, i.e. IBBI, in framing of regulation and ignored the already settled prepositions laid down by Hon'ble Apex Court in various judgments that liquidation of CD is the last resort and every endeavour should be made to revive the CD and to keep it as a 'going concern'.[82]

Hon'ble NCLAT by setting aside Hon'ble Principal bench judgment in *Mohan Jems* now clarifies the position that in liquidation if CD is sold as a going concern as per regulation 32A of Liquidation Regulations, then Liquidator should move forward for the closure of the liquidation process under regulation 45(3)(a) of Liquidation Regulations and there is no need of dissolution of the CD and it is not a mandate under the Code that liquidation should be followed by dissolution of the CD and even after liquidation CD can survive.[83]

ADVANTAGES OF SALE AS A GOING CONCERN

(a) Maximisation of value of the assets: The main aim of the Liquidator in liquidation process of the CD is to maximise the value of the assets of the CD and selling the CD as a going concern would yield more value as than any other mode of sale prescribed in liquidation.[84]

(b) Chance of revival of company even in liquidation: Liquidation is a statutory death of the company however, selling a company as a going concern give CD one more chance of revival which is the basic objective of the Code. Going concern sale protects the identity of the CD and give it a chance to protect the legal existence of the company and to retain the employees of the company.[85]

(c) Time saving process: Sale of CD as a going concern is less time consuming and less costly rather than selling assets of the CD individually. Further successful purchaser is able to take the possession of the company by simply depositing the sale consideration and it does not have to go through the inter-creditors' negotiation rounds.[86]

LIMITATIONS OF SALE AS A GOING CONCERN

(a) No check: During approval of resolution plan, AA has duty/ power to check the whether the plan approved by the CoC has provision for its effective implementation or whether it comply with the requirement provided under section 30(2) of the Code. However, in case of sale as a going concern in liquidation, AA does not have any such power or duty.[87]

(b) **No formal order for approval of sale:** AA's order for approval of resolution plan is a formal order that binds every creditors to the resolution plan and it specify that all the liabilities of the creditors will extinguish against CD and they receive money against their dues as per approved resolution plan however, in sale as a going concern in liquidation, buyers are not protected against the liabilities as there is no formal order by AA that can discharge/ extinguish pre-CIRP liabilities.[88]

(c) Sale depends on relinquishment of right by secured creditors: Under section 52 of the Code, secured creditors have option to either relinquish their security interest from the estate of CD or to not relinquish their security interest. Possibility of exploring the option of going concern sale of CD company in liquidation depends on the decision of the secured creditor to relinquish its security interest, only if secured creditor relinquish its security interest in favour of liquidation estate of the CD then only Liquidator can explore the option of sale of CD as a going concern.[89]

(d) Creditors does not have a say: In resolution plan approval, members of the CoC have right to negotiate with the RA on the plan that RA proposed and has the responsibility to check the interest of all the stakeholders. However, in sale of company as a going concern no such provision is there.

(e) Clean slate: Unlike resolution plan where RA gets reliefs and concessions at the time of the approval of resolution plan by AA, in going concern sale of a CD successful bidder has to approach AA for reliefs and concessions and even sometimes AA denies to provide because of lack of any specific provision.[90]

CONCLUSION

Sale of a CD as going concern is an option introduced by the judicial activism to achieve the goal of maximisation of value of the assets of the CD. However, due to lack of specific provision that can guide the procedure make it a craggy path for both purchaser as well as for stakeholders. Therefore, it requires legislative or judicial intervention to lay down the path for smooth process so that objectives of the Code can be achieved in real sense. In authors opinion there is a need to introduce provisions to make it mandatory for the Liquidator to approach AA for the confirmation of sale of CD as a going concern so that a formal order can be passed by AA binding on all the stakeholders of the CD and confirming the sale of the CD as a going concern and can grant a clean slate to purchaser to start a company afresh.

Further, the AA should provide right of hearing to Income Tax Department before passing final order of confirmation of sale of CD as a going concern so that relief such as carry forward of losses should be provided to the successful purchaser as provided by the AA during approval of resolution plan. Bar of section 29A should be relaxed in going concern sale of CD by keeping a cap of liquidation value, it provide promoters a chance to purchase a CD in liquidation only if they offer over and above liquidation value so that maximum value can be fetch by Liquidator and specific provision should be made in sale document that proceeds recovered from the avoidance transactions are distributed among stakeholders as per section 53 of the Code.

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11

IBC – BALANCING FAIRNESS AND EQUITY

— *Pooja Singla and Vinay Pandey*

Executive Summary

The Insolvency and Bankruptcy Code, 2016 (IBC / Code) was enacted to address the troubling shortcomings in existing staggered insolvency laws in India and to bring them under one umbrella. The Code aims to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

The Insolvency Law Committee in its February 2020 Report (February 2020 Report) noted that the purpose of insolvency law is to provide a collective process for resolving insolvency of a financially distressed debtor.[1] As highlighted by the Bankruptcy Law Reforms Committee report *'a collective mechanism for resolving insolvency within a framework of equity and fairness to all stakeholders'* is one of the hallmarks of a well-developed insolvency resolution regime.[2] In fact, the degree of creditor participation is considered a key factor in determining the effectiveness of an insolvency regime. For instance, the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes recommend that creditor interests should be safeguarded by appropriate means that enable creditors to effectively monitor and participate in insolvency proceedings to ensure fairness and integrity.

The UNCITRAL Legislative Guide on Insolvency also stressed on 'ensuring equitable treatment of similarly situated creditors', 'impartial resolution of insolvency' and 'preservation of the insolvency estate to allow equitable distribution to creditors' for achieving a collective insolvency resolution regime.[3] These principles are derived from three core features that most well developed bankruptcy and insolvency resolution regimes share: a linear process that both creditors and debtors follow when insolvency is triggered; a collective mechanism for resolving insolvency within a framework of equity and fairness to all stakeholders to preserve economic value in the process; a time-bound process either ends in keeping the firm as a going enterprise, or liquidates and distributes the assets to the various stakeholders.

In view of the recommendations and suggestions of various committees regarding fairness and equity, this paper covers eight broad areas of the Code in order to examine the effectiveness of its provisions in achieving its intended objectives and the way ahead.

Keywords: Fairness, Equitable, Resolution, Committee of Creditors, Resolution Professional

INTRODUCTION

'We can do better…We can't ignore the inequalities that persist in our justice system that undermines our most deeply held values of fairness and equality'.

- Hillary Clinton

An effective insolvency and bankruptcy law is one that delicately balances the interests of all the stakeholders by imbibing the principles of fairness and equity in its design and implementation. A general understanding of these principles in the context of an insolvency and bankruptcy regime implies that all creditors get a minimum fair share from the resolution or liquidation of the corporate debtor (CD). While it is fairly subjective to determine what constitutes being fair and equitable, a proxy indicator to measure it could ideally include the identity of all creditors and their nature (financial, operational, etc.), amount claimed, terms of credit and priority ranking in the claim. Another working formulation to measure fairness could be a comparison between the distribution of what is finally awarded amongst the various creditors and the weighted distribution of the total original claims.

This paper aims to examine the extent to which the provisions of the Code are fair and equitable in the following broad areas:

- Collation of claims vs. admission of claims.
- Powers and duties of committee of creditors (CoC).
- Resolution vs. liquidation – what suits whom?
- Treatment of provident fund and other similar dues: CIRP vs. liquidation.
- Fee of Resolution Professional (RP) vs. Liquidator.
- Extent of procedural fairness as well as judicial review involved.
- Obligation of the resolution applicant to implement the resolution plan in terms of divergent market circumstances.
- Judicial remedies for Service Providers.

COLLATION OF CLAIMS Vs. ADMISSION OF CLAIMS

Question under Consideration

The insolvency resolution and liquidation process under the Code provides for submission of claims by the creditors within a specified period. On the basis of collation of claims by the RP, CoC is formed, the commercial wisdom of which decides the fate of the CD. The voting power of the members of CoC depends on their share in the value of claims. Under corporate insolvency resolution process (CIRP), the resolution plan is prepared by the interested resolution applicants considering the position of the CD disclosed in the information memorandum (IM) which contains the list of creditors and amount of their claims admitted. The resolution plan, once approved, is binding on all the stakeholders. The claims not admitted or not considered by the RP get extinguished. Also, in liquidation, the claims admitted by the Liquidator are only considered while distribution of assets of the CD under waterfall mechanism. It is hence clear that verification and admission of claims is one of the important duties of the Insolvency Professional (IP) under the Code. The provisions of the Code strive on the protection of interest of all creditors while also considering the liquidation as a last resort. It aims for resolution of the company to ensure value maximisation and going concern.

Section 18 of the Code cast a duty on the Interim Resolution Professional (IRP) to receive and collate the claims submitted by the creditors pursuant to the public announcement. However, section 40 of the Code provides for admission or rejection of claims after its verification by the Liquidator. Taking into consideration the role that value of claims play under the CIRP, and also keeping in mind the objective of the Code being resolution and reorganisation of the CD, is it fair to limit the powers of RP to collation and verification of claims while empowering the Liquidator to admit or reject claims?

Legal Jurisprudence

In an appeal filed before the Hon'ble National Company Law Appellate Tribunal (NCLAT / Appellate Tribunal) in the matter of *M/s. Prasad Gempex v. Star Agro Marine Exports Pvt. Ltd. & Ors.*,[4] the question arose for consideration is whether the RP has jurisdiction to decide or reject the claim of one or another financial creditor (FC) or operational creditor (OC). With respect to the claims, it was observed that a suit or application can be filed against the CD, in terms of provisions of section 60 of the Code. The relevant portion of section 60 is quoted below-

> ……(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…..

Hon'ble NCLAT held that it is clear that notwithstanding the order passed under section 31 of the Code, it is open to a person to file a suit or an application against the CD for admission of the claim after completion of the period of moratorium.

A similar issue fell for consideration before the Hon'ble NCLAT in *M/s. Dynepro Private Limited v. Mr. V. Nagarajan.*[5] The Hon'ble NCLAT held that RP has no jurisdiction to decide the claim of one or other creditors, including FC, OC, secured creditor or unsecured creditor.

The powers of RP also fell for consideration before the Hon'ble Supreme Court in the matter of *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*[6] In the said judgment, the Hon'ble Supreme Court held that RP has no adjudicatory power and that he has to vet and verify the claims made and ultimately determine the amount of each claim. As opposed to this, the Liquidator in the liquidation proceedings under the Code has to consolidate and verify the claims and either admit or reject such claims under sections 38 to 40 of the Code.

In a judgment passed by the Hon'ble Supreme Court in the matter of *committee of creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors.*,[7] it has been held that the role of the RP is not adjudicatory but administrative. Further, with respect to the claim, it has been stated that in the CIRP, all claims must be submitted to and decided by the RP so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the CD.

In the matter of *Mr. Navneet Kumar Gupta (Resolution Professional of Monnet Power Company Limited) v. Bharat Heavy Electricals Limited,* [8] Hon'ble NCLAT considered the issue relating to jurisdiction of the RP to reject the claim of OCs without going into the evidence. This appeal was filed by the RP against the order of Adjudicating Authority (AA), which held that the RP has wrongly disallowed the substantial claim in its entirety and directed the RP to re-examine the claim on the basis of the accounts and evidence and if the evidence corroborated the claim, the same should also be taken into account while finalising the total claim of the creditor. The Hon'ble NCLAT while deciding the issue opined that the RP has no adjudicatory powers. Therefore, RP was directed to act in accordance with the directions of the AA.

In the matter of *Mr. S. Rajendaran, Resolution Professional of PRC International Hotels Private Limited v. Jonathan Mouralidarane,*[9] Hon'ble NCLAT held-

> ……we are of the opinion that the 'Resolution Professional' had no jurisdiction to "determine" the claim as pleaded in the Appeal. He could have only "collated" the claim, based on evidence and the record of the 'Corporate Debtor' or as filed by Jonathan Mouralidarane ('Financial Creditor'). If an aggrieved person thereof moves before the Adjudicating Authority and the Adjudicating Authority after going through all the records, comes to a definite conclusion that certain claimed amount is payable, the "Resolution Professional" should not have moved in Appeal, as in any manner, he will not be affected…

International Practice

The practice followed in UK regarding the process of verification of claims has been studied. Chapter 2 of the Insolvency (England and Wales) Rules 2016[10] deals with – 'Creditors' claims in administration, winding up and bankruptcy'. The relevant extract is produced below -

> **Admission and rejection of proofs for dividend**
>
> 14.7. (1) The office-holder may admit or reject a proof for dividend (in whole or in part).
>
> (2) If the office-holder rejects a proof in whole or in part, the office-holder must deliver to the creditor a statement of the office-holder's reasons for doing so, as soon as reasonably practicable.

Appeal against decision on proof

14.8. (1) If a creditor is dissatisfied with the office-holder's decision under rule 14.7 in relation to the creditor's own proof (including a decision whether the debt is preferential), the creditor may apply to the court for the decision to be reversed or varied.

(2) The application must be made within 21 days of the creditor receiving the statement delivered under rule 14.7(2).

(3) A member, a contributory, any other creditor or, in a bankruptcy, the bankrupt, if dissatisfied with the office-holder's decision admitting, or rejecting the whole or any part of, a proof or agreeing to revalue a creditor's security under rule 14.15, may make such an application within 21 days of becoming aware of the office-holder's decision.

(4) The court must fix a venue for the application to be heard.

(5) The applicant must deliver notice of the venue to the creditor who delivered the proof in question (unless it is the applicant's own proof) and the office-holder.

(6) The office-holder must, on receipt of the notice, file the relevant proof with the court, together (if appropriate) with a copy of the statement sent under rule 14.7(2).

(7) After the application has been heard and determined, a proof which was submitted by the creditor in hard copy form must be returned by the court to the office-holder.

From the above, it can be inferred that the Office Holder *akin* to that of an RP in India has the power to reject the claim of a creditor and an opportunity is given to the creditor at the initial stage itself to raise objection against the decision of rejecting his claim. This practice avoids the filing of petitions at the later stage of the process.

Conclusion

The adjudication of a claim under the Code is the legal process by which the right to claim against the CD is to be decided by the proper authority. However, after going through the provisions of the Code, regulations made thereunder and relevant judgments, it can be concluded that with respect to verification and determination of claims, the role of the IRP/RP is not adjudicatory but administrative. Therefore, in case the IRP/RP does not accept any claim of a creditor during the CIRP, then it is the AA which will decide the admission or rejection of claim during the CIRP upon filing of an application by such creditor whose claim has not been admitted by the IRP/RP. However, during the process of liquidation, the Liquidator himself can admit or reject a claim based on his verification of claims. While there may not be any practical difference between (a) verification of claims by the IRP/RP who then enters it in the list of creditors and (b) admission or rejection of claims by the Liquidator, the lack of provision empowering the IRP/RP to admit or reject the claim brings uncertainty in the claim admission process during CIRP and also lead to unnecessary delays due to aggrieved creditors resorting to appeals before the AA.

The Code prescribes that the appeal to a rejection of claim by the Liquidator has to be filed within 14 days of the decision of the Liquidator. However, a similar provision imposing a time limit on the creditor with a rejected claim to approach the AA is missing under the resolution process. This may allow claims by lax creditors and frivolous claims to be made before the AA at any stage of the CIRP which may disrupt the process. This is even more concerning due to the tendency of the AA to admit claims even at a stage after the CoC had approved the resolution plan.

To bring certainty and to ensure timely completion of CIRP, it is important that the RPs are also empowered to make quasi-judicial determination of claims in line with the powers granted to Liquidator under the liquidation process. Also, the AA needs to be careful of approving the resolution plans while appeals to the rejection of claims are pending. Mandatory timelines to file an appeal against the rejection of claims and disposal of such appeals by AA is need of the hour.

POWERS AND DUTIES OF COMMITTEE OF CREDITORS

Question under Consideration

Under the Code, the CoC plays a very important role in the entire process. It has been vested with great powers and responsibilities, which further leads to the resolution of a company under distress. Given the wide range of powers given to CoC, be it to replace the RP or approving the CIRP cost or taking the utmost decision of resolution or liquidation of the CD, it is considered as the supreme decision-making body in the CIRP. The committee consisting of FCs is thus expected to exercise the ability to assess the commercial viability and willingness to change the existing terms of liabilities in negotiation.

Appropriateness and fairness of decisions taken during the resolution process have been an intensely debated question since the implementation of the Code. Increasingly, dependence is being laid on the commercial wisdom of the CoC as the key decision-making body especially in the context of rescuing the CD through a sustainable resolution plan. Given their key responsibilities under the Code, the objectivity of the CoC in its decision making and its ability to best address the interests of the CD as well as all other concerned stakeholders is as important as the rescue of the CD itself.[11] While the RP is bound by a well-defined code of conduct and is continuously monitored by the Insolvency and Bankruptcy Board of India (IBBI), should CoC be placed on the same footing and be regulated/monitored?

Legal Jurisprudence

In the matter of *K Shashidhar v. Indian Overseas Bank and Ors.*[12], the Hon'ble Supreme Court discussed the aspect of approval or rejection of resolution plan by the CoC in detail and very clearly stated that-

> ….there is an intrinsic assumption that financial creditors are fully informed about the viability of the corporate debtor and feasibility of the proposed resolution plan…The opinion on the subject matter expressed by them after due deliberations in the CoC meetings through voting, as per voting shares, is a collective business decision. The legislature, consciously, has not provided any ground to challenge the "commercial wisdom" of the individual financial creditors or their collective decision before the adjudicating authority. That is made non justiciable……

It is clear that the limited judicial review available, which can in no circumstance trespass upon a business decision of the majority of the CoC, has to be within the four corners of section 30(2) of the Code, insofar as the AA is concerned, and section 32 read with section 61(3) of the Code, insofar as the Appellate Tribunal is concerned. Thus, while the AA cannot interfere on merits with the commercial decision taken by the CoC, the limited judicial review available is to see that the CoC has taken into account the fact that the CD needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including OCs has been taken care of.

In the matter of the *committee of creditors of Essar Steel Limited v. Satish Kumar Gupta*[13], the Hon'ble Supreme Court described the National Company Law Tribunal (NCLT) as having a 'handsoff' approach.

In this judgment, the Hon'ble Supreme Court reiterated that the limited judicial review available with the AA can be exercised only where the CoC has abdicated its responsibility of considering important parameters such as maximisation of asset value, that the CD needs to keep going as a going concern, balancing the interest of all stakeholders, etc.

International Practice

In UK, the Administrator performs the functions *akin* to that of an RP under Indian insolvency regime. It is the duty of the Administrator[14] that he performs his functions with the objective of rescuing the company as a going concern; achieving a better result for the company's creditors as a whole than would be likely if the company were wound up; realising property in order to make a distribution to one or more secured or preferential creditors; and must perform his functions in the interests of the company's creditors as a whole.

The creditors of a company can establish a creditors' committee; however, their role is limited to assisting the Administrator in discharging his functions. To monitor the conduct of Insolvency Practitioners in UK, statement of practices (SIP) is laid down. The SIP 15[15] provides that where an Office Holder considers their professional judgement should override the views of a committee, the Office Holder should clearly document why it is inappropriate to follow the views of the committee and provide an explanation to the committee. Creditors should be able to make an informed decision on whether they wish to be nominated to serve on a committee. Office Holders should advise creditors (or in relation to a creditors voluntary liquidation, ensure that creditors are advised) in writing how they may access suitable information on the rights, duties and the functions of the committee prior to inviting nomination of committee members. Office Holders should exercise professional judgement according to the circumstances of the case whilst having regard to the views of the committee. Office Holders should ensure that such views do not fetter their decision making. Hence, the role of the Office Holder is wider as compared to the committee.

Considering the wider role of Office Holders/Administrators, SIPs are laid down which acts as a code of conduct for the professionals.

Conclusion

The Code was introduced in order to overhaul the insolvency and bankruptcy regime in India. As such, it is a carefully considered and well thought piece of legislation which sought to shed away the practices of the past. The legislature has also been working hard to ensure that the efficacy of this legislation remains robust by constantly amending it based on its experience. Consequently, the need for judicial intervention from the NCLT and NCLAT should be kept at its bare minimum and should not disturb the foundational principles of the Code. This conscious shift in their role has been noted in the report of the Bankruptcy Law Reforms Committee (2015).

There appears to be no global consensus on the optimum approach to achieve an objective and transparent CIRP. The Code, in India, imposes this duty largely on the CoC, which is best placed to maintain the CD as a going concern. An appropriate code of conduct for CoC members has the potential to support procedural certainty and fairness to the CIRP. The introduction of principles and processes such as transparency, prior due diligence and disqualification for misconduct, may further strengthen the ability of the CoC to exercise its commercial wisdom for the benefit of the CD, while also ensuring that the interests of all stakeholders are best served.[16]

RESOLUTION Vs. LIQUIDATION – WHAT SUITS WHOM?

Question under Consideration

Section 30 of the Code provides for approval of the resolution plan by the CoC by a vote of not less than 66% of voting share of the FCs. The CoC may also decide to liquidate the CD, in case it does not satisfy with the resolution plan or if no resolution plan is received. However, the explanation to section 33(2) of the Code indicates that CoC may take the decision to liquidate the CD, any time after its constitution and before the confirmation of the resolution plan, including at any time before the preparation of the IM. Hence, the Code provides flexibility to CoC to decide the resolution or liquidation of the CD from the first day itself.

While the provisions contained in section 30 of the Code regarding submission of resolution plan has adequate safeguards to protect the interests of the OCs and dissenting FCs and for the fair and equitable distribution of resolution value among the creditors, it still empowers the CoC to decide the fate of the CD – the decision of resolution or liquidation vests with the CoC. The role of RP is limited to examination of resolution plans to ensure that it is in accordance with the provisions of the Code and to present the same to the CoC for its approval. The distribution order given in section 53 of the Code provides priority to the secured creditors over other creditors, whereas the amounts due to the government rank last in the order of distribution in the event of liquidation. There may be certain situations where a particular class of creditors prefers liquidation over resolution.

For instance, if the resolution value quoted by the resolution applicant is close to the liquidation value of the CD, secured creditors may recover more in the event of liquidation than resolution because in the event of resolution, there is no specified distribution order i.e., the resolution value may be allocated among the creditors in any proportion. In such cases, the secured creditors may push a viable company into liquidation. There is a possibility that the resolution value may be negotiated with the resolution applicant in favour of FCs while providing only the liquidation value to the OCs who have no say in the entire process.

The IP is one of the four pillars of the Code and is considered the backbone of the entire insolvency resolution process. However, when it comes to taking the most important decision for the CD i.e., to give it a new life or to let it die, IP has no other role than to act as a middleman between the CoC and the resolution applicant. Have the present provisions and the procedures specified therein been able to achieve the objectives of the Code in terms of reorganisation, resolution and balancing the interests of stakeholders by relying on the commercial wisdom of the CoC?

Legal Jurisprudence

The CoC decides the viability of the resolution plan according to its commercial wisdom as regards the outstanding debts and assets of the CD. The supremacy of commercial wisdom of the CoC has been reaffirmed time and again by the AA, the Appellate Tribunal and the Apex Court.

In the matter of *K. Sashidhar v. Indian Overseas Bank & Ors.*[17], Hon'ble Supreme Court noted that the legislature, while enacting the Code, has consciously not provided any ground to challenge the commercial wisdom of the individual FCs or their collective decision before the AA and this is made non-justiciable. It held that neither the AA nor the Appellate Tribunal has been endowed with the jurisdiction to reverse the commercial wisdom of the dissenting FCs.

In its landmark ruling in *committee of creditors of Essar Steel India Ltd v. Satish Kumar Gupta & Ors.*[18], Hon'ble Supreme Court again re-emphasised the primacy of the commercial wisdom of the CoC by holding that the scope of judicial review by AA while approving a resolution plan was required to be within the parameters of section 30(2) of the Code and with respect to the Appellate Tribunal, it must be within the parameters of section 32 read with section 61(3) of the Code. It further observed that the AA or the Appellate Tribunal can under no circumstance trespass upon a commercial decision of the majority of the CoC.

A careful perusal of the aforementioned rulings indicates that the commercial wisdom of the CoCs cannot be questioned by the courts, except on limited grounds. The courts have recognised the crucial role played by the CoCs and found that it is the best judge to understand and take commercial decisions for the business. However, the ambit of this 'commercial wisdom' of the CoC has always been a topic of discussion, particularly in the context of judicial interference exercised by courts over the decision-making power of the CoC. In various matters, the judiciary has interfered questioning the massive haircuts accepted by the CoC.

International Practice

In UK, the Administrator performs the functions *akin* to that of an RP under Indian insolvency regime. It is the duty of the Administrator[19] that he performs his functions with the objective of rescuing the company as a going concern; achieving a better result for the company's creditors as a whole than would be likely if the company were wound up; realising property in order to make a distribution to one or more secured or preferential creditors; and must perform his functions in the interests of the company's creditors as a whole.

The creditors of a company can establish a creditors' committee; however, their role is limited to assisting the Administrator in discharging his functions. To monitor the conduct of Insolvency Practitioners in UK, statement of practices (SIP) is laid down. The SIP 15[20] provides that where an Office Holder considers their professional judgement should override the views of a committee, the Office Holder should clearly document why it is inappropriate to follow the views of the committee and provide an explanation to the committee. Office Holders should exercise professional judgement according to the circumstances of the case whilst having regard to the views of the committee.

From the above, it can be inferred that the Office Holder under UK insolvency regime has the right to express his independent views and to disagree with the views of the creditors' committee. This is also appropriately recorded in writing. Also, the role of the Office Holder is wider as compared to the committee.

Conclusion

One of the main objectives of the Code is to balance the interests of all stakeholders. In order to achieve this objective, there is a need of oversight of the process by an independent person, which is the IP in this case. A particular beneficiary of the process cannot be expected to take fair decisions in the interest of all beneficiaries of that process. It is required to cast a duty on the IP to oversee the resolution process and ensure the value maximisation of the CD by securing maximum resolution value and its equitable distribution among the creditors. While the commercial wisdom of the CoC is relevant in terms of viability and feasibility of the resolution plan, the best efforts may be made by the IP to secure maximum resolution value and distribution part may be left in the hands of IP. Also, there is a need to empower the IP to form his opinion on the resolution plans before presenting the same to the CoC members.

TREATMENT OF PROVIDENT FUND AND OTHER SIMILAR DUES: CIRP Vs. LIQUIDATION

Question under Consideration

One of the primary objectives of the Code is to balance the interest of all the stakeholders. To accomplish the said objective, the Code and the regulations made thereunder have made certain provisions to protect interests of workmen and employees. Once the CIRP gets initiated, workmen and employees of the CD are required to submit their claims in Form D, under regulation 9 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) along with proof thereof. The claims of the workmen and employees include various components such as gratuity, provident fund, and pension etc. These components require monthly/annual contributions by the employer and in few cases by the employee also. For instance, under the Employees Provident Fund & Miscellaneous Provisions Act, 1952 (PF Act), an employer is required to contribute to the provident fund of the employee. The issue for deliberation here is the difference in treatment of provident fund and other similar dues in CIRP vs. liquidation.

Legal Jurisprudence

Section 53(1)(b) provides that the workmen's dues for the period of 24 months preceding the liquidation commencement date shall be treated at par with the debts owed to secured creditors. Further, section 53(1)(c) provides priority to wages and unpaid dues owed to employees other than workmen for the period of 12 months preceding the liquidation commencement date over the dues unpaid to Central or State Governments and unsecured debts. Section 36(4)(a)(iii) provides that amounts payable to workmen or employees from provident fund, pension fund and the gratuity fund do not form part of the liquidation estate. Therefore, the law explicitly provides that, in cases where the pension fund, provident fund and gratuity fund are duly maintained by the CD, these funds do not form part of liquidation estate for the purpose of distribution of assets under section 53 of the Code. However, issue may arise in cases where such funds are not maintained by the CD. While the Code is silent in this respect, there are various conflicting judgments of NCLT and NCLAT on these issues.

In the matter of *Precision Fasteners Ltd v. EPFO*[21] , Hon'ble NCLT, Mumbai observed that dues of provident fund, pension fund and gratuity fund are to be deemed as an asset of the workmen or employees irrespective of whether they have been maintained in a separate account or not by the company under liquidation. It further observed that by including all sums due to any workmen or employee from the provident fund, the pension fund and the gratuity fund under section 36(4)(a) which covers assets owned by a third party which are in possession of the CD, an overarching interest and title has been created in favour of the workmen in respect of the provident fund, etc.

However, in the matter of *Mr. Savan Godiwala v. Mr. Apalla Siva Kumar*[22], the Hon'ble NCLAT allowed the appeal filed by the Liquidator against the order of the Hon'ble NCLT. The Hon'ble NCLT has held that, '*The Liquidator cannot avoid the liability to pay gratuity to the employees on the ground that Corporate Debtor did not maintain separate funds, even if, there is no fund maintained, the Liquidator has to provide sufficient provision for payment of gratuity to the Applicants according to their eligibility*'. The Hon'ble NCLAT while allowing the appeal observed that in a case, where no fund is created by a company, in violation of the statutory provisions of the Payment of Gratuity Act, 1972, then the Liquidator cannot be directed to make the payment of gratuity to the employees because the Liquidator has no domain to deal with the properties of the CD, which are not part of the liquidation estate. It held that-

> Therefore, this Appellate Tribunal is of the considered opinion that the Adjudicating Authority erred in directing the Liquidator to make provision for payment of Gratuity to workers, as per their entitlement. Thus, Appeal is allowed and the impugned direction to 'Liquidator' to make provision for payment of Gratuity, without their being a separate fund in this regard, is set aside.

Unlike liquidation, there is no provision in the Code for treatment of provident fund and other similar dues during CIRP. In practice, the Employee Provident Fund Organization (EPFO) files the claims which consist of employee's contribution deducted from wages of the employees, employer's contribution, interests and penalties component, if any. There may be cases where employers have defaulted in their contributions. In such cases, where the amounts are due from the employer to the EPFO authorities, the provisions of the PF Act applies which provides that the amount due to the EPFO shall have the first charge over the assets of the CD.

Further, there are divergent views regarding the employer dues payable to EPFO during CIRP. One position is that these dues should be ranked at par with the other statutory authority dues or government dues because fundamentally, they all belong to the same class. The second position is that these dues should be paid in priority before other creditors keep in mind the welfare of workers and the PF Act provisions. It has also been observed that there is no clarity in CIRP about the treatment of provident fund and other dues in the resolution plan. The issue arises especially in cases where these dues are treated at par with other statutory authority dues or government dues and not awarded full payment in the resolution plans. This then becomes another reason for challenging the validity of the resolution plan thus causing delay in its implementation.

In the matter of *Sikander Singh Jamuwal v. Vinay Talwar & Ors.*[23], NCLAT, Principal Bench held that there is no conflict between the provisions of section 17B of the PF Act and the Code and directed the resolution applicant to pay provident fund dues to the employees. Similar observations were made by Hon'ble NCLAT in the matter of *Tourism Finance Corporation of India Ltd. v. Rainbow Papers Ltd.*[24] It held as-

> .....However, as no provisions of the 'Employees Provident Funds and Miscellaneous Provision Act, 1952' is in conflict with any of the provisions of the 'I&B Code' and, on the other hand, in terms of Section 36 (4) (iii), the 'provident fund' and the 'gratuity fund' are not the assets of the 'Corporate Debtor', there being specific provisions, the application of Section 238 of the 'I&B Code' does not arise. Therefore, we direct the 'Successful Resolution Applicant'- 2nd Respondent ('Kushal Limited') to release full provident fund and interest thereof in terms of the provisions of the 'Employees Provident Funds and Miscellaneous Provision Act, 1952' immediately, as it does not include as an asset of the 'Corporate Debtor'.

Conclusion

Considering the judgments mentioned above, it is clear that provident fund and other similar dues are the part of social welfare scheme of the state, and these dues will always have preference over the economic benefits. This principle is very well explained by Hon'ble NCLT Mumbai in the matter of *Precision Fasteners Ltd v. EPFO*[25], wherein it has observed-

> ....The right of all other creditors over the assets of the company is a property right, whereas workmen dues, more specially PF dues of workmen, are interwoven with Right to Life because the workmen all through their life save some portion of the hard earnings for their later life after retirement, if such

> sums are being interlinked on par with debts of the creditors of the company, secured or unsecured as the case may be, then it is nothing but diluting most valuable and inalienable right of a person on par with a property right subordinate to right to life .....

The Hon'ble Apex court in the matter of *State of Jharkhand and Ors. v. Jiterdra Kumar Srivastava and Anr.*[26] described the importance of these social benefits and held that, '*It is an accepted position that gratuity and pension are not the bounties. An employee earns these benefits by dint of his long, continuous, faithful and un-blemished service….*'

In view of the above said, there is a need to convert the said established principles into the explicit provisions of Code and thereby allowing the smooth transmission of social security benefits to workmen and employees.

FEE OF RESOLUTION PROFESSIONAL Vs. LIQUIDATOR

Question under Consideration

Section 30 of the Code provides for resolution plan to contain provision for the payment of insolvency resolution process costs in priority to the payment of other debts of the CD. Section 5(13) includes the fee payable to RP in the 'insolvency resolution process costs', which is decided by CoC. The fee is not specified in fixed terms under the law. However, it does provide for reasonableness of the same under the IBBI (Insolvency Professionals) Regulations, 2016. The circular dated June 12, 2018 issued by IBBI provides guidance on factors to be considered in determination of what is reasonable. Hence, it can be said that the determination of fee payable to RP is left to market forces and is not linked to resolution value of the CD. On the contrary, section 34 of the Code provides for the Liquidator to charge fee for the conduct of liquidation proceedings and in proportion to the value of the liquidation estate assets. Liquidation regulations provide that the fee may be decided by the CoC or the Liquidator may be paid as a percentage of the amount realised and of the amount distributed, as specified. As per the fee matrix provided in the regulations, Liquidator is given an incentive to realise maximum in the first six months. This is aimed at ensuring the completion of liquidation as early as possible and to save value erosion for the assets of the CD.

RP makes every possible effort to revive the company and secure maximum resolution value. While resolution is considered as the first priority, there is no incentive for RP to channelise his energy and efforts towards resolution rather than liquidation as there is no linkage of the fee paid to RP with the quantum, of resolution value of the CD. The fixation of fee for RP, if left to market forces, is more problematic due to the following reasons:

(a) In CIRP, the scope of work i.e., verifications of claims, preparation of evaluations matrix, evaluation of resolution plan, forming opinion of avoidance transactions etc. is much critical and hence, it is difficult to quantify all these efforts.

(b) Further CoC do not always consist of scheduled commercial banks. There are cases where CoC consist of OCs, homebuyers and other non-institutional creditors who are not competent enough to evaluate the efforts of RP and determine the fee accordingly.

It is once again reiterated that one of the core objectives of the Code is to revive the company and to get it back on its feet, whereas the liquidation is considered as the last resort. In view of the objective of the Code, can it be considered as fair and equitable to allow the Liquidator to charge his fee based on realisation and distribution of assets of the CD, while leaving the fixation of fee of RP to the market forces?

Legal Jurisprudence

In the matter of *Mr. Jayesh N. Sanghrajka, Erstwhile RP of Ariisto Developers Pvt. Ltd v. The Monitoring Agency nominated by the CoC of Ariisto Developers Pvt. Ltd.,*[27] Hon'ble NCLAT held that 'success fees' which is more in the nature of contingency and speculative is not part of the provisions of the Code and the regulations and the same is not chargeable. This appeal was filed by the RP against observations and findings of the AA while approving the resolution plan submitted by successful resolution applicant, wherein it disagreed with the CoC which has approved success fees to the RP of an amount of ₹ 3 crore.

In the matter of *Mr. Devarajan Raman RP Poonam Drum & Containers Pvt. Ltd. v. Bank of India Ltd.*,[28] Hon'ble NCLAT held that fixation of fee of RP is not a business decision depending upon the commercial wisdom of the CoC. It directed the AA to decide the fee of RP.

International Practice

UK

Chapter 4 of the Insolvency (England and Wales) Rules 2016 deals with – 'Remuneration and expenses in administration, winding up and bankruptcy'.[29] The relevant extract is produced below -

> **Remuneration: principles**
>
> 18.16. (1) An administrator, liquidator or trustee in bankruptcy is entitled to receive remuneration for services as office-holder.
>
> (2) The basis of remuneration must be fixed—
>
> (a) as a percentage of the value of—
>
> (i) the property with which the administrator has to deal, or
>
> (ii) the assets which are realised, distributed or both realised and distributed by the liquidator or trustee;
>
> (b) by reference to the time properly given by the office-holder and the office-holder's staff in attending to matters arising in the administration, winding up or bankruptcy; or
>
> (c) as a set amount.
>
> (3) The basis of remuneration may be one or a combination of the bases set out in paragraph (2) and different bases or percentages may be fixed in respect of different things done by the office-holder.

US

Section 326 of the Chapter 3 contained in Title 11 of the US Bankruptcy Code deals with – Limitation on compensation of trustee. The relevant extract is produced below -

326. Limitation on compensation of trustee

> (a) In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services, not to exceed 25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims….

Conclusion

While the decision of the NCLAT made it clear that success fees, which is contingent and speculative does not form part of the provisions of the Code and is, therefore, not chargeable, it did not clarify whether success fees otherwise can be claimed by the RP or not.

In this respect, where the provisions of the Code and rules thereunder, require that the fee charged by the RP should be reasonable, not inconsistent with applicable regulations and in a transparent manner, a framework that puts a cap on the fee that can be charged by RPs would be beneficial. Further, given the extensive nature of the responsibilities undertaken by RPs and their role in resolution of the CD, an incentive should be given to charge the fee as a percentage of the resolution value achieved. There is a need to reward the RP and Liquidator equally in consonance of the efforts put in and results achieved.

EXTENT OF PROCEDURAL FAIRNESS AS WELL AS JUDICIAL REVIEW INVOLVED

Question under Consideration

A resolution plan placed for the approval of AA under section 31 of the Code needs to, *inter-alia*, meet the criteria specified under section 30(2)(e) of the Code which provides that the resolution plan shall not contravene any of the provisions of the law for the time being in force. The essence behind the said law is that the companies are regulated by various legislations which have been enacted to ensure the development of the economy as well as the interests of other stakeholders.

The UNCITRAL Legislative Guide on Insolvency Law while discussing the relationship between insolvency law and other laws states as follows-

> 26. A more general issue to be considered is how an insolvency law will relate to other substantive laws and whether the insolvency law will effectively modify those laws. Relevant laws may include labour laws that provide certain protections to employees, laws that limit the availability of set-off and netting, laws that limit debt-for-equity conversions and laws that impose foreign exchange and foreign investment controls that could affect the content of a reorganization plan….. The relationship between insolvency law and other laws should be clear and, where possible, references to the other laws should be included in the insolvency law.
>
> 27. While the institutional framework is not discussed in any detail in the Legislative Guide, some of the issues are touched upon below. Notwithstanding the variety of substantive issues that must be resolved, insolvency laws are highly procedural in nature. The design of the procedural rules plays a critical role in determining how roles are to be allocated between the various participants, in particular in terms of decision-making. To the extent that the insolvency law places considerable responsibility upon the institutional infrastructure to make key decisions, it is essential that infrastructure be sufficiently developed to enable the required decisions to be made.[30]

Till specific provisions providing for relaxations in resolution plans are incorporated in the Code, the AA will remain bound by section 30(2)(e), and cannot allow reliefs, concessions etc., in contravention of extant laws. However, it has been observed that different approaches have been adopted by various NCLTs granting waivers, reliefs and concessions resulting in confusion amongst the stakeholders. Few instances in this regard are provided below-

(a) Stamp Duty

In case of *Monnet Ispat and Energy Limited*, the AA denied the exemption from levy of stamp duty in respect to reconstruction and amalgamation proposed in resolution plan in absence of express provision conferring power on the Bench to grant such waiver. However, no direct observation has been made by AA in cases of *Technovva Plastic Industries Pvt Ltd, The Rubber Products Limited, Euro Pallets Private Limited, Shree Kedarnath Sugar and Agro Products Limited*.

(b) Legal Proceedings

In cases of *V.S. Texmills Private Limited* and *Technovva Plastic Industries Pvt Ltd*, AA observed that approval of resolution plan does not mean automatic waiver or abatement of legal proceedings pending by or against the CD as those are subject matter of the concerned competent authorities having their proper/ own jurisdiction. However, in case of the *Rubber Products Limited*, AA's order did not make any specific observation on the relief of abatement or withdrawal of proceedings.

It is important to note here that the order of Hon'ble Supreme Court in *Ghanashyam Mishra and Sons Pvt. Ltd. through Authorised Signatory v. Edelweiss Asset Reconstruction Company Ltd. through the Director & Ors*[31]. restricts the continuation of only recovery proceedings.

(c) Contingent Liabilities

In the case of *Murli Industries Limited*, AA held that the contingent liabilities shall continue to exist and no waiver can be provided for them. However, in case of *Euro Pallets Limited*, no direct observation has been noted in relation to the contingent liabilities.

Further, in the absence of any specific laid down procedures, resolution applicants are seeking various waivers, reliefs and concessions which are not even related to the business of CD. The same issue was highlighted recently by NCLT Ahmedabad bench vide its order in the matter of *SBI v. Mackeil Ispat & Forging Limited*[32] -

> ………We are, however, constrained to observe that many of the waivers, reliefs and concessions sought are without any application of mind. The RP would have been well-advised to look into these aspects and advise the CoC in this regard. For example, Sl No.24 at page 31 supra seems to cast a duty on the RoC to take on record and implement the Plan, upon approval of the Plan by NCLT, without any further compliances. How the RoC can be thrust with this duty is baffling, to say the least. Second, Sl No.6 at pages 20-21 supra plans for an exit route without any implications or penalties for the Resolution Applicant even when the Resolution Applicant is expected to do the most basic due diligence. A condition such as this one should never have passed muster. Third, even though section 32A of the Code grants immunity in respect of the corporate debtor and its property in a case where there is a fresh start through a resolution plan resulting in change of management, there are innumerable clauses under the waivers, concessions and reliefs section stating the same thing. These are quite unnecessary and involves wastage of resources on the part of the Adjudicating Authority which can otherwise be profitably employed in disposing of other applications which are in crying need of attention. These

> have been routinely observed in previous cases involving approval of resolution plans. Therefore, the IBBI may like to think of issuing appropriate directions to the insolvency professionals in this regard……

Further, the February 2020 Report notes that requirement for governmental approvals other than statutory approvals which are often not part of statute but may be contained in licenses, concessions, etc. would not be covered under section 31(4) of Code. The report also notes committee's view to provide a procedure for taking approvals or seeking objections during the CIRP itself since this provides certainty on the resolution plan's implementation upfront.[33]

Conclusion

In order to streamline the process and to resolve the said issues, introduction of compliance audit in line with due diligence conducted in mergers and acquisitions and vetting of all contracts entered into by CD with authorities to list the compliances/ approvals that may be needed to ensure continuance of the contracts, may prove helpful.

Form H prescribed under regulation 39(4) of the CIRP Regulations may be amended to include the list the compliances/ approvals. Further, after the resolution plan has been filed with the AA, procedure followed in schemes of compromise, arrangement and amalgamation (CAA) under the Companies Act, 2013 vis-à-vis informing the authorities may be introduced. A time window may be given to the concerned authorities to either provide their approval (as per the governing law) for continuance of the contracts or for raising objection.

The provision of deemed approval present in CAA may be introduced in the Code by virtue of which after the expiry of the time window provided to the concerned authority, their approval will be deemed. This explicit provision will have over-riding effect on the other laws which provide a specific procedure for grant of approval. Also, clarity on what exemption/ waivers fall under jurisdiction of AA under the Code may be provided.

OBLIGATION OF THE RESOLUTION APPLICANT TO IMPLEMENT THE RESOLUTION PLAN IN TERMS OF DIVERGENT MARKET CIRCUMSTANCES

Question under Consideration

Section 30 of the Code deals with approval of resolution plan by the CoC, post which the same is submitted to the AA for final approval. Section 31 of the Code provides that the resolution plan, once approved by the AA, it shall be binding on all the stakeholders including the Government. While there is a time limit of 180 days extendable by 90 days for the completion of insolvency resolution process, there is an overall timeline of 330 days for the mandatory completion of the process, which includes any extension of period granted and time taken in legal proceedings. It is pertinent to note that there is no time limit for approval of resolution plan by the AA, once the resolution plan is submitted after the approval of CoC. The Hon'ble Supreme Court, in one of the matters observed, *'Judicial delay was one of the major reasons for the failure of the insolvency regime that was in effect prior to the IBC. We cannot let the present insolvency regime meet the same fate…….'*

While the Code binds all stakeholders of the resolution plan approved by the AAs, strict time limits are not enforced on the Courts to ensure the completion of insolvency resolution process within a definite time frame. The delays at the end of AAs can significantly affect the value of the CD. In a competitive environment with regular market changes, there can be a great impact on the resolution value offered in the plan by the resolution applicants. However, the resolution applicants are obligated to implement the resolution plan in all circumstances. Can the damage happened on account of judicial delays be set off by burdening the resolution applicants with the non-implementable resolution plans, which may result in failures going forward hence adding to the count of CDs under distress?

Legal jurisprudence

While the judicial delays has been noted by the Apex Court, it has also been observed that long delays in approving resolution plans under the Code by the AAs affect their implementation. *'These delays, if systemic and frequent, will have an undeniable impact on the commercial assessment that the parties undertake during the course of the negotiation……',* the Hon'ble Supreme Court highlighted, in the judgment in the matter of *Ebix Singapore Pvt. Ltd v. committee of creditors of Educomp Solutions Ltd*.[34]

According to a report filed by the Ministry of Corporate Affairs' Standing Committee on Finance (2020-2021) on the 'Implementation of Insolvency and Bankruptcy Code- Pitfalls and Solutions'[35], there is a delay in the resolution process with more than 71 per cent cases pending for more than 180 days, which is in deviation of the original objective and timeline for CIRP envisaged by the Code.

In the matter of *Kundan Care Products Ltd. v. Mr. Amit Gupta and Ors.,*[36] while disposing the appeal against the rejection of application made for withdrawal of resolution plan (owing to the resolution plan becoming commercially unviable and unfit for implementation on account of delay in the conclusion of CIRP), Hon'ble NCLAT emphasised on maintaining the sanctity of the resolution process and held that a resolution applicant whose resolution plan has been approved by CoC cannot be permitted to withdraw its resolution plan. A similar view was made in the matter of *committee of creditors of Educomp Solutions Ltd. v. Ebix Singapore Pvt. Ltd.*[37] by Hon'ble NCLAT, that once the resolution plan is approved by the CoC, the applicant cannot take a 'topsy turvy' stance, and hence, cannot withdraw the approved resolution plan.

The judgment of Apex Court in the same matter is noteworthy as it re-emphasised that the speed of resolution as contemplated in the Code is sacrosanct. It further held that resolution by itself is not the goal of the Code but resolution within the specific timeframe is in the essence of the Code. It has been explicitly clarified by the Apex Court that upon the approval of the resolution plan by the CoC, the same cannot be withdrawn and hence, it inflicts a mandatory character on the implementation of the approved plan. It further held –

> ... We urge the NCLT and NCLAT to be sensitive to the effect of such delays on the insolvency resolution process and be cognizant that adjournments hamper the efficacy of the judicial process. The NCLT and the NCLAT should endeavor, on a best effort basis, to strictly adhere to the timelines stipulated under the IBC and clear pending resolution plans forthwith. Judicial delay was one of the major reasons for the failure of the insolvency regime that was in effect prior to the IBC. We cannot let the present insolvency regime meet the same fate….[38]

Conclusion

We refer to one of the principles of administrative law i.e., 'Doctrine of legitimate expectation', which says that there is an expectation of a benefit, relief or remedy that may ordinarily flow from a promise or established practice. Such expectations should not be based on the strength of sporadic, casual or random acts. Also, such expectations should not be unreasonable, illogical or invalid.

When a resolution applicant submits a resolution plan, that plan is prepared based upon the prevailing market and economic conditions. Hence, there is a reasonable expectation on the part of resolution applicant that plan will be approved within a reasonable time. Further, there is a latin maxim i.e., '*Actus Curiae Neminem Gravabit*' which says that an act of the Court shall prejudice no man. Therefore, resolution applicant shall not be prejudiced from any delay on the part of AA in approving the resolution plan.

Resolution plans are prepared in accordance with the IM furnished to the prospective resolution applicants. IM is prepared on a certain date and the same facts cannot hold true until an indefinite time. The resolution applicants submit their proposals on the basis of the facts given in the IM. Also, the position of a CD is bound to change, and any negative change would affect the RA who has agreed to resurrect the CD on the basis of such facts. Although the resolution applicants assumes the risk, they might face in implementing the resolution plan, however, they cannot be burdened with the baggage of change in circumstances for an infinite time.

In view of the observations of NCLT, NCLAT and Apex court regarding delays in approving resolution plans and considering that speed is the essence of the Code, reasonable timelines need to be brought in for the approval of resolution plans. While there may be certain exceptional circumstances where the time limit may be exceeded, the law cannot let it turn into a common practice across courts. The withdrawal of the resolution plan, after its approval by the AA, cannot be a solution as this may lead to a vicious circle resulting in constant value erosion of the CD and may never come to an end. Hence, all the stakeholders of the process and enforcement authorities need to be equally footed to achieve the desired outcomes of the Code.

JUDICIAL REMEDIES AVAILABLE TO SERVICE PROVIDERS

No Provision of Appeal against Rejection of Registration as an IP

Section 201 of the Code provides for the registration of Insolvency Professional Agency (IPA) by IBBI. Under section 201(2) of the Code, IBBI may reject the application of IPA by passing a reasoned order. Further, under 201(5) of the Code, IBBI may, by order, suspend or cancel the certificate of registration granted to IPA on some specific grounds.

Section 202 of the Code provides that any IPA which is aggrieved by the order of IBBI made under section 201 may prefer an appeal to NCLAT in such manner as may be specified by the regulations. Similar appellate jurisdiction is also provided to Information Utility under section 211 of the Code. However, there is no such mechanism provided in case of registration of IP and an IP has to file an appeal before Hon'ble High Court under the writ jurisdiction provided in Article 226 of Constitution.

No Provision of Appeal by IPA against Order of Disciplinary Committee of IBBI

Section 220 of the Code provides that Disciplinary Committee (DC) may pass an order against IPA where IPA has contravened any provisions of the Code or regulations made thereunder. However, there is no appellate mechanism provided in the Code against the order passed by the Disciplinary Committee. It means that any order passed by the Disciplinary Committee will be challenged in the Hon'ble High Court under the writ jurisdiction provided under Article 226 of the Constitution of India.

In exercise of the powers conferred by sections 196, 201, 202, 219 and 220 read with section 240 of the Code, IBBI has issued the IBBI (Insolvency Professional Agencies) Regulations, 2016. Under regulation 9 of the said regulations, an appeal may be preferred against the order of DC under section 202 of the Code to the NCLAT. However, in Code, there is no appellate mechanism provided against the order passed by the DC.

Practice in Other Regulators

Securities Appellate Tribunal (SAT) is a statutory body established under the provisions of section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under this Act or any other law for the time being in force. Consequent to Government Notification No. DL-33004/99 dated May 27, 2014, SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No. DL-(N)/04/0007/2003-15 dated March 23, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory and Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalisation) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the rules and regulations framed thereunder.

Conclusion

Since there is no appellate mechanism provided under the Code, against the orders passed by the DC, any order passed by the DC gets challenged in the Hon'ble High Court under the writ jurisdiction provided under Article 226 of the Constitution of India. Below are some of the advantages of having the administrative tribunal as appellate authority rather than the High Court:

(a) Administrative tribunals are less formal, less expensive, and a faster way to resolve disputes than by using the traditional court system.

(b) Tribunal members who make decisions (Adjudicators) usually have special knowledge about the topic they are asked to consider. Judges, however, are expected to have general knowledge about many areas of law, and not specific expertise about the law in the case they are hearing.

(c) In a tribunal hearing, matter may be heard by one Adjudicator sitting alone, or by a panel of several Adjudicators, if the matter is complicated. These Adjudicators have special training and experience to conduct hearings. But, like a trial in court before a judge, the Adjudicators are responsible for conducting fair hearings and making final decisions on the issues. They do this by considering the evidence and applying the legislation, case law, and policies that relate to your case.

Considering the above, there is a need to amend the Code and authorise NCLAT as an Appellate Authority so as to provide equitable judicial remedies to all service providers under the Code.

[1] Report of the Insolvency Law Committee, February, 2020.
[2] Report of the Bankruptcy Law Reforms Committee, Vol. I, November, 2015.
[3] UNCITRAL Legislative Guide on Insolvency Law, 2005.
[4] CA (AT) No. 291-2018.
[5] CA (AT) No. 229 and 262-2018.
[6] Writ Petition (Civil) No. 99 of 2018.
[7] Civil Appeal No. 8766-67 of 2019 and Ors.
[8] CA(AT)(Insolvency) 743-2018.
[9] CA(AT)(Insolvency)No. 1018 of 2019.
[10] Chapter 2, The Insolvency (England and Wales) Rules 2016.
[11] Sriram B. (2021), "A code of Conduct for Committee of Creditors", Quinquennial of Insolvency and Bankruptcy Code, 2016.
[12] Civil Appeal No. 10673 of 2018 with CA No. 10719 of 2018, CA No. 10971 of 2018 and SLP (C) No. 29181 of 2018.
[13] Supra Note 7
[14] Schedule B1, The Insolvency Act, 1986, United Kingdom.
[15] Statement of Insolvency Practice 15, England and Wales.
[16] Supra Note 11
[17] Supra Note 12
[18] Supra Note 7
[19] Supra Note 14
[20] Supra Note 15
[21] MA 576 & 752/2018 in C.P.(IB) 1339(MB)/2017.
[22] CA(AT)(Ins) No. 1229 of 2019.
[23] Company Appeal(AT) (Ins)No. 483 of 2019.
[24] CA (AT) (Insolvency) No. 354 of 2019.
[25] Supra Note 21
[26] Civil Appeal No. 6770 of 2013.
[27] Company Appeal (AT) (Ins) No. 392 of 2021.
[28] CA (AT) (Insolvency) No. 646 of 2020.
[29] Chapter 4, The Insolvency (England and Wales) Rules 2016.
[30] Supra Note 3
[31] Civil Appeal No. 8129 of 2019 and other appeals.
[32] IA (IB) No.398/KB/2021 in CP (IB) No.213/KB/2019.
[33] Supra Note 1
[34] Civil Appeal No. 3224 of 2020 with other appeals.
[35] The Ministry of Corporate Affairs, Report of the Standing Committee on Finance, August, 2021.
[36] CA(AT)(Ins)No. 653 of 2020.
[37] CA(AT)(Ins)No. 203 of 2020.
[38] Supra Note 35

12

Resolving Discoms under IBC:

A Comparative Law Approach

— *Pratik Datta*

Executive Summary

The Indian power sector continues to be in a precarious financial situation. State-owned electricity distribution companies (discoms) are the weakest link in the sector. Despite various policy initiatives, discoms remain highly stressed. The Madras High Court in *Tamil Nadu Generation and Distribution Company v. Union of India (September 17, 2021)* has recently clarified that discoms could be subjected to resolution under the Insolvency and Bankruptcy Code, 2016 (IBC). Against this backdrop, this paper reviews the US and UK experience with insolvencies in the electricity sector to identify few critical idiosyncratic issues that may potentially arise during discom resolution through the IBC. First, the ability to reject Power Purchase Agreements (PPAs) through insolvency resolution, as is possible in the USA, is particularly crucial in the Indian context. Second, Indian policymakers should consider if special insolvency regimes for energy suppliers, like the ones in the UK, are necessary to ensure continuity of a discom's services during insolvency resolution. Overall, the aim of the paper is to use this comparative approach to inform the discussion on discom resolution under the IBC in India. Hopefully it will trigger a larger policy debate on the subject in future.

Keywords : Discom Resolution, Power Purchase Agreements (PPAs), Supplier of Last Resort.

INTRODUCTION

The power sector is a crucial pillar for any thriving economy. Yet, three decades after 'power sector reforms' was enshrined as a key component of India's larger process of economic liberalisation, the Indian power sector remains hobbled with high levels of losses and debts, the latter serving as a continued drag on the state exchequer.[1] The weakest link in this sector is the distribution sector, dominated by state government owned discoms, which have been battling with various challenges including aggregate technical and commercial (AT&C) losses, ensuring financial viability and providing electricity access to all households.[2] In the past two decades, many policy attempts have been made to resolve the challenges faced by discoms. The Electricity Regulatory Commissions Act, 1998 was aimed at improving the governance framework. The Electricity Act, 2003 paved the way for competition through unbundling, altering the industry structure by rapid capacity addition through private sector participation in electricity generation. To revive the financially stressed discoms, the central government has initiated bail-out packages such as Financial Restructuring Plan (FRP) in 2012-13 and the *Ujwal* DISCOM Assurance *Yojana* (UDAY) in 2015-16. Further, several government schemes such as the Rajiv Gandhi *Grameen Vidyutikaran Yojana* (RGGVY), *Deen Dayal Upadhyaya Gram Jyoti Yojana* (DDUGJY), Restructured Accelerated Power Development and Reforms Programme (R-APDRP), and Integrated Power Development Scheme (IPDS), have aimed at increasing the number of connections and strengthening the distribution network.[3] Despite all these initiatives, total discom losses for FY 2021 is estimated to be ₹ 0.9 trillion and accumulated losses at about ₹ 5 trillion. In March 2021, overdue payments from discoms to generators were at about ₹ 0.68 trillion.[4]

Financial distress in the distribution sector could have widespread implications. It may disrupt the possibility of achieving the goal of universal access to electricity for all, especially for small and rural consumers. Moreover, failure of discoms to pay power generators in time could lead to spreading the financial contagion vertically across the entire power sector. Finally, financial distress within the overall power sector would make it more difficult for India to move up the path of carbon transition into cleaner energy sources, which could have wide-ranging implications from climate change to geopolitics. Evidently, there is an urgent need to develop a robust policy framework to comprehensively mitigate the financial distress within discoms.

Against this backdrop, recent developments have made it reasonably clear that state government-owned discoms could be subjected to insolvency proceedings under the IBC. On September 17, 2021, the Madras High Court admitted a writ petition challenging the jurisdiction of the National Company Law Tribunal (NCLT) under section 9 of the IBC to entertain an insolvency proceeding against the petitioner, the Tamil Nadu Generation and Distribution Company (TANGEDCO).[5] TANGEDCO is a state government-owned discom, that is a 'government company' under section 2(45) of the Companies Act, 2013. In relation to this matter, the Union Ministry of Power wrote a letter to the Secretary, Department of Legal Affairs on November 8, 2021, clarifying that insolvency proceedings could indeed be initiated against a 'government company'.[6] On the same day, the Madras High Court dismissed TANGEDCO's writ petition. The court's reasoning was two-fold. First, the IBC does not provide any exemption to government companies. Consequently, NCLT had jurisdiction to entertain an insolvency proceeding against a government company under the IBC.[7] Second, section 86(1)(f) of the Electricity Act, 2003 applies only to disputes between distribution licensees and generating companies, not between an operational creditor and a generating company. Therefore, this provision of the Electricity Act, 2003 does not come in the way of triggering insolvency proceeding against discoms under the IBC.[8] These legal developments are likely to prompt creditors of financially distressed state discoms to trigger IBC proceedings, either seeking resolution or at least, as a legal strategy to settle their dues with a discom bilaterally.[9] This may put to test the IBC's ability to handle the most challenging financial distress in the power sector.

The IBC being a general corporate insolvency law was never designed to handle idiosyncratic sectoral issues. Yet, discom resolution raises several such issues. For instance, a discom is a utility that provides an essential service. Continuity of supply of such services to consumers during insolvency resolution is of utmost importance. Even the National Company Law Appellate Tribunal (NCLAT) has acknowledged that initiation of insolvency resolution against a discom 'may cause problem to the public in general' and accordingly, encouraged settlement between a discom and the applicant creditor.[10] Consequently, successful discom resolution under IBC may require additional institutional safeguards to ensure continuity of supply.[11] Similarly, the tariffs that discoms may charge their consumers are often regulated by the State Electricity Regulatory Commission (SERC). There has been much concern that such tariffs are often kept extremely low, even when wholesale electricity prices fluctuate, which in turn impacts the financial viability of discoms. Similar concerns also arise from PPAs. The tariff negotiated in a PPA may subsequently become relatively higher compared to the market rate, increasing the financial burden on a discom. It is therefore not surprising that multiple states including Punjab, Gujarat, Rajasthan, Karnataka and Uttar Pradesh have tried to renegotiate or cancel prior PPAs to aid state-owned discoms. The Andhra Pradesh High Court recently pushed back against this trend, holding that PPAs cannot be renegotiated subsequently.[12] Successful discom resolutions may therefore have to grapple with the need for tariff changes and the appropriate institutional architecture necessary to alter such tariffs during discom resolution. Addressing such peculiar sectoral concerns may require revisiting the IBC in its application to discoms.

Against this backdrop, this paper aims to identify the idiosyncratic issues that have arisen out of electricity utility resolution by comparing how legal regimes in the USA and the UK approach the problem. The comparative approach that the paper seeks to adopt will be characterised by a functional perspective. It will briefly review the evolution of the electricity sector in these two countries and identify the idiosyncratic legal issues that could potentially arise during electricity utility resolution. Overall, the aim of the paper is to use this comparative approach to inform the discussion on discom resolution through the IBC in India. Hopefully it will trigger a larger policy debate on the subject in future.

USA

Background

From 1929 until 1936, the USA experienced 53 utility holding company bankruptcies involving $1.7 billion in outstanding securities.[13] For the next half century, no privately owned public utility filed for bankruptcy. This was probably because until mid-1960s, America's demand for electricity doubled every decade from the turn of the century. Analysts predicted that this growth would continue. To satisfy the demand, utilities turned to nuclear power as a relatively inexpensive, reliable, and pollution-free alternative to oil, coal, and hydroelectric power. In the 1970s, inflation, high-interest rates, and the high cost of crude oil pushed up the operating and construction costs of nuclear power plants far above projected levels. Utility rates rose in response to increased costs compelling customers to conserve electricity. Growth in demand for electricity declined correspondingly. Subsequently, the brush with disaster at a nuclear power plant in Three Mile Island in 1979 heightened public awareness of the risks and intensified governmental scrutiny. Because of all these factors, it was soon realised that many of the utilities' incomplete nuclear power plants might be too expensive to complete.[14] It was against this backdrop that allocating the costs of abandoned nuclear plants assumed significance.[15]

The state commissions had to decide what portion, if any, of abandoned plant costs may be recovered through rates from rate-paying consumers and what portion must be absorbed by the utility and its shareholders. If a state commission denied cost recovery of abandoned nuclear plants by a utility company, and the cost of the plant was excessive in comparison to the utility's other assets, the utility would be unable to absorb these costs internally. It was in this context that utilities started exploring options under the US Bankruptcy Code from early 1980s.[16]

In the 21st century, utility bankruptcies have become more common in the USA. A host of regulatory measures and innovations have enabled new generation sources (natural gas, wind and solar) to become cost-competitive with traditional generation sources (nuclear and coal).[17] The declining prices of new generation sources have already reduced the demand for coal-generated electricity. As the generation segment has become more competitive, several electric utilities have approached bankruptcy courts for relief. For example, FirstEnergy filed for Chapter 11 in 2018 after being dragged down by its failing nuclear and coal plants. At the same time, climate change is intensifying natural disasters, threatening the long-term viability of traditional, vertically integrated electric utilities. For instance, the wild-fire liability faced by PG&E prompted the utility to file for bankruptcy in 2019.[18]

Idiosyncratic issues

The US Bankruptcy Code has very few special provisions for utility bankruptcies.[19] Consequently, utility insolvencies have been treated under the same legal provisions as any other financially distressed company. Yet, electricity utility resolution in the USA has raised one idiosyncratic issue – the scope of debtor's rejection powers under section 365 of the US Bankruptcy Code.

Section 365(a) of the Bankruptcy Code provides that '*... the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor*'. In other words, a debtor-in possession has the power to reject any executory contract with the bankruptcy court's approval. This rejection power is appealing to electric utility debtors who are often burdened by expensive, long-term PPAs because these agreements are challenging to modify or abrogate outside of bankruptcy.[20] Attempts to reject PPAs under this provision of the US Bankruptcy Code has led to frictions between the bankruptcy court and the Federal Energy Regulatory Commission (FERC).[21]

The FERC is a creature of the Federal Power Act, 1920. This statute was enacted since the American Congress felt that federal regulation was necessary to protect public interest. The US Supreme Court has noted that the principal purpose of the FPA is the protection of electricity consumers through the 'orderly development of plentiful supplies of electricity at reasonable prices'.[22] Although energy contracts are privately negotiated, the contracts must be filed with FERC and certified as 'just and reasonable' to be lawful under the FPA. And FERC is vested with the 'exclusive authority to determine the reasonableness of wholesale [electricity] rates'. FERC's plenary authority over wholesale energy contracts led to the filed rate doctrine.[23] The doctrine states that a utility's right to a reasonable rate under the FPA is the right to the rate which the FERC files or fixes and, except for review of FERC orders, a court cannot provide a right to a different rate. It has been widely recognised that the filed rate doctrine prohibits any collateral attack in the courts on the reasonableness of rates, and that the only forum for such a challenge is the FERC.[24] Though FERC has exclusive authority to modify filed rate wholesale energy contracts, its power to modify the rates is not limitless. The US Supreme Court has held that the FERC can change a filed rate being charged by an electricity generation company under a contract only when 'the rate is so low as to adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory'.[25] Section 206 of the FPA authorises FERC, after hearing, to change filed rates if it determines that they are unjust or unreasonable.

The provisions in these two different statutes – the Bankruptcy Code, 1978 and the Federal Power Act, 1920 – have led to much friction between the bankruptcy court and the FERC in relation to restructuring of electricity utility companies. A brief review of some of the most relevant cases would illustrate the issue better.

For instance, in *Mirant Corporation v. Potomac Electricity Power Company,*[26] the corporate debtor (CD) Mirant was in the business of producing and selling energy products and in trade of energy products. Through an asset purchase and sale agreement with Pepco, it acquired most of Pepco's power purchase agreements (PPAs). However, some of the PPAs required the PPA supplier's consent for assignment. Mirant and Pepco agreed that for the unassigned PPAs, Pepco will continue purchasing under these PPAs and Mirant would be under an obligation to purchase the same electricity from Pepco. Subsequently, Mirant wanted to reject this agreement using section 365(a) of the Bankruptcy Code. The Bankruptcy Court allowed the rejection on the ground that the energy was no more needed by Mirant to fulfill its obligation to supply. The court held that the FPA would not pre-empt the district court from exercising its jurisdiction under the Bankruptcy Code since the CD's main justification for rejection of the PPA, in that case, was that it did not need the energy it was purchasing under the PPA to fulfill its own obligations to supply electricity. Such rejection of the contracts would only have an 'indirect effect' on the rate.[27]

In a subsequent decision in *re Calpine Corporation*, the CD Calpine was in power generation business. It entered into PPAs to supply electricity and raised debt to build power plants. Subsequently, natural gas prices went up. The prices fixed under PPAs were significantly lower. Calpine sought to use section 356(a) to terminate these PPAs. It argued that it was ready to supply the same amount of electricity but at competitive market prices. The court refused termination. The court held that the bankruptcy court's authority cannot be exercised so as to interfere with the jurisdiction of the FERC, a federal agency, acting in its regulatory capacity.[28] The court observed that because there is nothing in the Bankruptcy Code that limits FERC's jurisdiction, Calpine cannot achieve in bankruptcy court what neither it, nor any other party in that case, nor any other federally regulated energy company in the country could do without seeking FERC approval, that is, to cease performance under the rates, terms, and conditions of filed-rate wholesale energy contracts in the hopes of getting a better deal.

Finally, in *re First Energy Solutions* (2019), First Energy Solutions (FES) was an electricity distributor. It distributed to retail and corporate clients and also supplied to the sport market. For its retail business, it was required to purchase Renewable Energy Credits (RECs). For this, it entered into 8 PPAs. From 2011 onwards, the regulations on RECs were relaxed. RECs became available for cheaper price. FES was also planning to exit the retail segment. The PPAs therefore became burdensome for FES since it did not need RECs at all. It was in this context that FES sought to reject those PPAs using section 365(a). The Court allowed this rejection.[29] The US Court of Appeals held that when a Chapter 11 debtor moves the bankruptcy court for permission to reject a filed energy contract that is otherwise governed by FERC, via the FPA, the bankruptcy court must consider the public interest and ensure that the equities balance in favor of rejecting the contract, and it must invite FERC to participate and provide an opinion in accordance with the ordinary FPA approach within a reasonable time.[30]

In a nutshell, section 365(a) of the US Bankruptcy Code has been successfully used by CDs in the USA to reject PPAs only when they are part of a genuine restructuring effort to overcome financial distress. However, courts have refused to allow rejections which were meant merely to renegotiate a better deal for the CD bypassing the jurisdiction of the FERC.

UK

Background

The electricity supply industry was nationalised in England and Wales in 1947. After three decades, the conservative party under Margaret Thatcher started privatising state-owned enterprises. From 1979 to 1992, some 39 companies were privatised, culminating with electricity utilities from 1990 that ended in 1995 with the sale of more modern nuclear plant. The breakup of the nationalised power suppliers into smaller privatised companies immediately increased market competitiveness, with new companies beginning to build their own Combined Cycle Gas Turbine (CCGT) stations from 1992. Major electricity suppliers increased in number from 16 in 1989 before privatisation to 39 in 2019. Major power producers (MPPs) increased in number from 6 in 1989 to 55 in 2019. The market share of smaller suppliers (outside the top nine) rose from 4% in 2010 to 20.4% in 2019, as new and smaller suppliers took market share from the large companies.

The Utilities Act, 2000 introduced new terms in suppliers' licences to enable Ofgem to revoke them in not less than 24 hours in circumstances where the licensee becomes insolvent. It also empowered Ofgem to appoint a Supplier of Last Resort (SoLR) for all types of customer (domestic and non-domestic) of an electricity supplier. This power was essential to ensure that all failed supplier's customers have continuity of supply. In December 2001 the gas and electricity supplier Enron Direct Limited failed. Its customers were bought by BGT. In October 2002, TXU Europe's supply business was sold to Powergen following TXU's financial difficulties. In June 2003 Maverick Energy Limited (a small non-domestic electricity supplier) went into administrative receivership; its customer contracts were subsequently sold to Atlantic Electricity and Gas Limited.[32]

It was against this backdrop that the Energy Act 2004 introduced the Energy Supply Company Administration, a special insolvency regime specifically created for companies that supply electricity in England and Wales pursuant to specific supply licences granted by Ofgem. In addition to creating a special administration regime for energy supply companies, there are also restrictions on the use of insolvency processes that would ordinarily be available under the Insolvency Act 1986, such as the ordinary out-of-court administration.

When smaller energy supply companies have gone insolvent, Ofgem used the SoLR mechanism to take over customer accounts. At times, the acquiring companies defaulted on balancing and settlement payments and network and distribution charges, distributing the costs across other market participants. Clearly, this resolution strategy was unsuitable for big energy supply companies. Consequently, the Energy Act, 2011 established a special administration regime for big energy supply companies to serve as a backstop for SoLR mechanism. The purpose is to ensure that if a large electricity supplier is in financial difficulty, arrangements are in place to allow the company to continue operating normally until it is rescued, sold or its customers transferred to other suppliers. The aim has been to reduce risk of contagion in energy markets, maintain market stability and therefore, protect consumers. In 2021, Bulb became the first energy supply company to be admitted to this special administration regime.

Idiosyncratic issues

Unlike the USA, the UK has evolved a special insolvency resolution regime for energy supply companies. A failing energy company is under a legal obligation to notify Ofgem that it is unable to pay its debt as they fall due. Ofgem prefers private trade sale of such a supply company. If trade sale is not achievable, Ofgem has the power to revoke the company's supply license within 24 hours' notice and appoint a Supplier of Last Resort (SoLR). If Ofgem cannot appoint a new supplier, it can use the Energy Supply Company Administration, a special administration regime under the Energy Act, 2004/2011. In that case, a special administrator runs the company until its business is restructured, sold, or has its customers transferred to other suppliers.

The SoLR is ideal to handle financial distress of small energy suppliers. The Ofgem asks other competing suppliers if they are willing to be considered as SoLR and the terms on which they would be willing to supply to the consumers of the failed energy supplier. Ofgem also has the power to direct a supplier to act as SoLR. Once SoLR has been identified, Ofgem revokes the license of the failed company and immediately places the supply with SoLR. The failed company is liquidated under general insolvency law.

Unlike SoLR, the Energy Supply Company Administration (ESCA) is meant for larger energy suppliers. This special administration regime alters the ordinary administration process under the Insolvency Act, 1986. It is primarily designed to ensure continuity of service or operation of the electricity supplier. The Secretary of State (or Ofgem with the consent of the Secretary of State) may apply to the court for the special administration order.[33] No out of court appointment is permitted. The court must be satisfied that the company is or is likely to be unable to pay its debts; or that grounds exist that would entitle the Secretary of State to apply to wind up the company in the public interest.[34]

The objective of the administration is to secure that energy supplies are continued at the lowest cost which it is reasonably practicable to incur until the company is either rescued as a going concern or, if that is not possible, transferred to another company as a going concern or, if that is not possible, transferred to two or more different companies.[35] The Administrator runs the company till it is restructured, sold or its customers are transferred to other suppliers. Unlike an ordinary administration, the Secretary of State may provide grants, loans, indemnities or guarantees to enable an energy administrator to finance the supply company's activities. Approval from Her Majesty's Treasury is needed for such financial support. Provision is made to recover any government funding from the company or, if it is not able to repay, through a cost recovery mechanism with the cost being borne by the industry.[36] In 2021, Bulb Energy with 1.7 million customers became the first company to go into ESCA.

CONCLUSION

Discom resolution raises a host of issues under insolvency law. Some relevant idiosyncratic issues that have arisen in this context in the USA and the UK have been identified in this paper. First, the ability to reject a PPA contract under insolvency law is particularly crucial in the Indian context. States like Punjab, Gujarat, Rajasthan, Karnataka and UP have tried to renegotiate or cancel PPAs. Recently, the Andhra Pradhesh High Court pushed back against this trend and reinforced the sanctity of PPAs. In this backdrop, the IBC may provide a workable middle ground to renegotiate burdensome PPAs which may be the cause of financial distress of a discom. In fact, rejection of a PPA was permitted under IBC through a resolution plan in the case of *Bhushan Steel*.[37] Additionally, the IBC empowers a resolution professional to amend or modify the contracts which were entered into before the commencement of the resolution.[38] This provision has been tested in very few cases till now.[39] The utility of this provision in modifying PPAs is yet to be tested in India. Second, continuity of service of a discom during resolution is of utmost importance. The UK has developed dedicated legal regimes such as SoLR and the ESCA to ensure continuity of discom services during resolution. One of the most important features of the ESCA is the ability of the Secretary of State to provide grants, loans, indemnities or guarantees to enable an energy administrator to finance the supply company's activities. The mechanism for recovery of the government funding is also clearly provided for. These are useful features that may be considered in the Indian context. Indian policymakers need to consider if a SoLR or ESCA type of regime for discoms could work in the Indian context. Overall, IBC could potentially offer a viable mechanism for discom resolution if these idiosyncratic issues are specifically addressed within the overarching framework of the law.

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14 Robinson, B., In re *Blackacre Power and Light: The Bankruptcy of a Public Utility*, 50 ALB. L. REV. 641 (1986).
15 This matter fell primarily within the jurisdiction of state utility rate-setting agencies. In general, rates must be low enough to provide service to customers at a reasonable price, yet not so low as to deprive the utility of a 'fair and reasonable' rate of return on its investment.
16 Supra Note 14
17 After the 1970s energy crisis, the Congress enacted the Public Utility Regulatory Policies Act of 1978 (PURPA) to promote the development of new generating facilities and to conserve the use of fossil fuels. Because the traditional utilities controlled the transmission lines and were reluctant to purchase power from non-traditional facilities, PURPA directed FERC to promulgate rules requiring utilities to purchase electricity from qualifying cogeneration and small power production facilities. PURPA disrupted the monopoly market structure by enabling certain non-traditional wholesale sellers, like renewable energy companies, to compel traditional public utilities to purchase their generation capacity and energy. Hirsh M. (2021), "Creatures of Congress Collide: Defending FERC's Ratemaking Authority in Electric Utility Bankruptcies", Columbia Business Law Review, Vol. 1:296.
18 Hirsh M. (2021), "Creatures of Congress Collide: Defending FERC's Ratemaking Authority in Electric Utility Bankruptcies", Columbia Business Law Review, Vol. 1:296.
19 For instance, section 1129(a)(6) which provides that any governmental regulatory commission with jurisdiction, after confirmation of the restructuring plan, over the rates of the debtor, must approve any rate change provided for in the plan, or such rate change must be expressly conditioned on such approval.
20 Supra Note 18
21 FERC inherited almost all the responsibilities of Federal Power Commission set up under the FPA. Much of what it didn't inherit went to the Department of Energy (DoE), but was subsequently delegated from DoE to FERC.
22 *N.A.A.C.P. v. Federal Power Comm'n*, 425 U.S. 662, 670 (1976)
23 *Montana-Dakota Utilities v. Northwestern Public Service Co.*, 341 U.S. 246 (1951)
24 FERC's jurisdiction and the filed rate doctrine extends to the terms and conditions of wholesale energy contracts. The filed rate doctrine is not limited to 'rates' per se. A change to the duration of a filed rate energy contract, would also come under FERC's jurisdiction. Because, once filed with FERC, wholesale power contracts become the equivalent of a federal regulation. *In re Calpine Corporation, et al*, US District Court SDNY, January 27, 2006.
25 *US Supreme Court, FPC v. Sierra Pacific Power Co.*, 350 U. S. 348, 352-353 (1956).
26 378 F.3d 511 (5th Cir. 2004).
27 Public utility PEPCO, pursuant to deregulation legislation, sold its electric generation facilities and assigned most of its power purchase agreements to Mirant, a power purchaser and provider. Because some of the power purchase agreements contained language that foreclosed PEPCO from assigning them, PEPCO and Mirant entered into a separate agreement (also FERC-regulated), which provided that PEPCO would continue to buy energy under the unassigned agreements and that Mirant would purchase that energy from PEPCO at the filed rates set in those contracts. When Mirant later filed for Chapter 11 bankruptcy, it sought to reject the contracts that bound it to buy the energy from PEPCO. *In re Mirant, 378 F.3d 511* (5th Cir. 2004).

28 Calpine Corporation was a power generator. It had entered into PPAs to supply electricity. It had taken debt to build power plants. However, natural gas price went up. Consequently, Calpine filed for Chapter 11 and asked for cancellation of PPAs since they were burdensome given that electricity prices fixed in the PPAs were significantly lower than prevailing electricity prices. However, Calpine was ready and willing to supply the same amount of wholesale electric power but at competitive market prices. *In re Calpine Corporation, et al*, US District Court SDNY, January 27, 2006.

29 *NLRB v. Bildisco & Bildisco* , 465 U.S. 513, 518 (1984).

30 FirstEnergy Solutions (FES) distributed electricity, buying it from its fossil-fuel and nuclear electricity-generating subsidiaries and selling it to retail clients, corporate affiliates, and in the spot market. Since at least 2003, regulations required FES to buy a certain amount of 'renewable energy credits' (RECs). But back in 2003, and until at least 2011, three things were very different than they are now: (1) FES's retail electricity sales were much greater, so its REC requirements were correspondingly greater; (2) the supply of RECs was more limited, so FES was compelled to enter long-term contracts to get enough RECs at an agreeable price; and (3) electricity prices were much higher and were expected to remain high. To ensure a long-term supply of RECs, FES signed eight power purchase agreements (PPAs). Under these PPAs, FES purchased the RECs (and the power, capacity, and ancillary services) from wind- and solar-based generating facilities, such as Duke and Maryland Solar. Also, FES signed three of the PPAs (93 MW of energy) to satisfy a subsidiary's consent decree with the United States Environmental Protection Agency (USEPA). Subsequently, the government has relaxed the REC requirements. There was also an abundance of RECs available for purchase; and energy and capacity prices became much lower. These market changes rendered the PPAs financially burdensome to FES, which had sold and was in the process of selling its entire retail business and has no commercial or regulatory need for the RECs from these PPAs. *In re FirstEnergy Solutions Corp.*, US Court of Appeals, December 12, 2019.

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COOPERATIVE TERRITORIALITY OR MODIFIED UNIVERSALISM IN CROSS-BORDER INSOLVENCY:

A CHOICE INDIA MUST MAKE

— *Priya Misra*

Executive Summary

Cross-border insolvency is a complex subject demanding clarity and certainty in a country's legal regime. India currently stands at crossroads where it has the liberty to embrace a robust, reliable and predictable cross-border insolvency regime. The United Nations Commission on International Trade Law (UNCITRAL) Model Law for cross-border insolvencies (MLCBI / Model Law) has been proposed as the suitable model for India but before its adoption, no matter how popular, India should step back and ponder over a bigger question that will help carve its path to a more consistent, robust and reliable cross-border insolvency law.

In order to do that, it needs to decide on the direction it wishes to take in this regard. Answers to these pertinent questions will guide Indian legislators to adopt/borrow/construct a law that reflects those goals, whether it is MLCBI, EC Regulation, chapter XIV of the US Code or its own indigenous creation. So, the primary question that India must deliberate on is -what should be the approach of its cross-border corporate insolvency law? Which school of thought should India adopt in its insolvency system- universalism or territorialism, or their milder forms, i.e. modified universalism or cooperative terrritorialism?

The research paper, thus, evaluates modified universalism and cooperative territorialism from international point of view and then weighs their relevance from Indian context to bring out the real debate. The paper then elaborates the confusion persisting in the Indian insolvency jurisprudence and culminates the dialogue with highlights on India's domestic insolvency needs, current situation and challenges in adopting the approaches.

Keywords: Modified universalism, Cooperative territorialism, Cross-border insolvency, UNCITRAL Model law on Cross-border insolvency, Universalism.

INTRODUCTION

By far, it has become clear that a unified global resolution for a transnational insolvency is an elusive concept that has not found any strong footing. In fact, after a long struggle and deliberate push by the United Nations, the UNCITRAL MLCBI, after nearly 25 years of introduction, still remains accepted/ adopted/ratified by only 49 countries. On one hand, these numbers are encouraging, given the slow pace of acceptance of international conventions and Model Laws and given that significant number of countries that India trades with[1], have adopted the model as a whole or with reservations. However, the downside of the Model Law has been that even after strong endorsements, its popularity is on the downfall as several group of nations are opting for regional agreements such as Organisation for the Harmonisation of Business Law in Africa (OHADA)[2], Association of South East Asian Nations[3], EU[4], etc.

India's approach to cross-border insolvency has been fraught with confusion and uncertainty, elements that should not be passed on in the cross-border insolvency chapter, whenever and however constructed. If one perceives the *Jet Airways case*, inconsistencies were apparent when tribunal initially refused the Dutch administrative agent's request to acknowledge the proceedings that were ongoing in the Netherlands against the company, which was later overturned by the appellate tribunal (and protocol followed). The inconsistent opinions of the tribunals demonstrated the lack of clarity regarding the approach towards cross-border insolvency law [5]. The case of *Videocon Industries Limited & Others*[6] built a dangerous precedent in the context of cross-border insolvency law. The NCLT Mumbai ordered consolidation of assets of foreign subsidiary companies for liquidation without any reference to the issues of international insolvency law sans any consultations with or consideration of the foreign creditors and the prevailing laws[7] of the subsidiaries' home countries. The lack of bigger picture in mind was apparent. If the approach towards cross-border insolvency law (school of thought) was determined by legislators, the dearth of a codified law on the issue would not have been an impediment.

Some scholars believe that UNCITRAL MLCBI is not the ultimate answer to India's precariously balanced cross-border insolvency issues. Much before the adoption of a Model Law, no matter how popular, India should step back and ponder over a bigger question that will help carve its path to a more consistent, robust and reliable cross-border insolvency law.

Unlike the current domestic corporate law and insolvency law where the judiciary and executive alike, have played guinea pig on the commercial law (mark of a country trying to stand on its own), the same experiment should not be conducted on transnational insolvency cases because uncertainty caused by frequent changes in law creates unreliability, adversely affects the country's standing in the global market. One of the most prominent reasons for such inconsistency and frequent amendments has been a lack of direction. In one of early speeches on Insolvency and Bankruptcy Code, 2016, the late minister of Corporate Affairs remarked that *'...it was anticipated that in the initial stages, there would be some teething trouble, the law had to be laid down and infrastructure had to be created...I must confess that it has moved on and its effectiveness is proved far better than what I had anticipated'.*[8] In other words, the new law of 2016, drafted within a year and enforced without much debate, was an experimental indigenous law that was supposed to be amended on the go, as and when the situation demanded, and was enacted swiftly to act against the 12 erring insolvent corporations. In the absence of a long-term plan and with the injection of frequent changes to the legal regime (whether by means of amendments to statute, rules or regulations or via case law), the developing jurisprudence landscape often seems confusing.

The debate for choice of insolvency legal system

India currently stands at crossroads where it has the liberty to embrace a robust, reliable and predictable cross-border insolvency regime. In order to do that, it needs to decide on the goal and direction it wishes to take in this regard. Answers to these pertinent questions will guide Indian legislators to adopt/borrow/construct a law that reflects those goals, whether it is MLCBI, EC Regulation, Chapter XIV of the US Code or its own indigenous creation. So, the primary question that India must deliberate on is -what should be the approach of its cross-border corporate insolvency law? Which school of thought should India adopt in its insolvency system- universalism or territorialism, or their milder forms, i.e., modified universalism or cooperative territorialism?

It is not an easy call. The choice of insolvency system directly effects the stakeholders in insolvency- corporate debtors (CD) who would shy away from establishing their registered office/headquarters in the jurisdiction that exposes them to proceedings and actions of other countries; creditors who would avoid investing in those nations that discriminate among creditors and protect local creditors over their foreign counterparts; shareholders, especially parent companies that wouldn't wish to invest/ float subsidiaries in jurisdictions that allow their assets to be dragged into the insolvency proceedings of subsidiary companies; promoters who would be discouraged if the company's interests are not protected; retail investors who would not wish to invest in asset-light companies; regulators who would have to step up vigilance of companies if forum shopping was allowed; and the list goes on.

PURE UNIVERSALISM AND TERRITORIALISM

Universalism was once upon a time, the ultimate goal of the transnational insolvency law where *'unitary bankruptcy proceeding takes place in a bankrupt's home country, which applies universally to all the bankrupt's assets and which receives worldwide recognition'.*[9] Pure universalism ideates a collective proceeding at global level where all assets are pooled together irrespective of their locations and all stakeholders are taken care of in that proceeding no matter from what country or state. But that remains good only in theory. Unified global management of the multinational companies/assets has become increasingly endangered with major economies' court decisions refusing to accept foreign proceedings, recognise foreign representatives or coordinate court proceedings[10]. It is clear to say that universalism is not achievable in the near or distant future[11] because most of the mature jurisdictions such as UK, US and most of EU have continued to enforce their own cross-border insolvency systems instead of unifying them.

In contrast, territorialism prescribes that the local assets should be used to satiate the claims of the local creditors through local proceedings, with meagre or no attention to foreign parties. In essence, territorialism stands on the pillars of sovereignty and territorial jurisdiction[12]. While territorialism brings certainty and clarity of law and enforcement, it also creates disparities in the treatment of similarly placed/same class of creditors merely on the basis of the jurisdiction where they are entitled to sue the CD. The number of proceedings also multiply because each jurisdiction initiates its own resolution process for the local assets[13] to serve the local stakeholders. This may often benefit the local creditors but would shrink the value of assets at the time of liquidation and the optimum price they could have generated. The other disadvantages of applying pure territorialism are that -

> Meaningful and systematic cooperation becomes difficult because some courts are not legally authorized to cooperate, while other courts have legal authorization but choose not to cooperate….. Territorialism leads to a less efficient ex ante allocation of capital because creditors cannot foretell where a debtor's assets will be during bankruptcy…. isolated asset administration drives local debtors and creditors to advance personal interests at the expense of creditors worldwide…[14]

Scholars advocate for universalism in insolvency proceedings because *'...bankruptcy is a collective process, designed to realise asset value and then distribute that value amongst creditors according to a scheme of priority based on legal rights, it is necessary for there to be a single proceeding operating under a single set of overall rules...'*[15] Although through the application of universalism the piece of pie that the local creditors may have received (had territoriality prevailed) shrinks, universalism ensures repayment to all, therefore catering to larger interests than just local creditors. Uniformity of treatment of similarly placed creditors and reduction of processes, costs and legal hassles (multiple proceedings) garner the theory of universalism with scholarly approval. All these aspects bring certainty to the entire transaction, an aspect that underlines international insolvency's goal. Pure universalism is considered the ultimate ideal for regulating cross-border insolvency cases while modified universalism remains the best solution pending the movement to true universalism.[16]

MODIFIED UNIVERSALISM AND COOPERATIVE TERRITORIALISM

Modified universalism has been defined by UK in the case of *Re HIH* as[17] *The principle of modified universalism requires that English courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution'.* This concept has been adopted and endorsed by the American courts as well in the famous case of *Maxwell Communications*[18] where the court reiterated that USA *'embrace[s] an approach to international insolvency which is a modified form of universalism accepting the central premise of universalism, that is, that assets should be collected and distributed on a worldwide basis but reserving to local courts discretion to evaluate the fairness of home country procedures and to protect the interests of local creditors'.* As per Prof. Westbrook –

> the key difference between the approaches of modified universalism and territorialism is that modified universalism takes a worldwide perspective, seeking solutions that come as close as possible to the ideal of a single-court, single-law resolution, while territorialism of any sort seems to me to be defined by a conviction that local creditors have vested rights in whatever assets can be seized by their courts when insolvency looms.[19]

While universalism has become more of a utopian concept because a single insolvency proceeding for a multinational company is impossible to achieve and territorialism may not result in protection of transnational stakeholders, modified universalism has always seemed to be a popular and accepted approach.[20] Countries have been seeking cooperation in terms of insolvency for a long time. Sincere attempts have been made in this respect through initiatives such as International Law Association of 1879, and the Hague Conference on Private International Law of 1904. Both universalism and modified universalism usually depend on the existence of single or unified or coordinated resolution process for a CD by resorting to a default nomenclature to ascertain the place of initiation of main proceedings, i.e., centre of main interest (COMI).

Prof. Mevorach defines the goal of modified universalism in the words, '*Adapted to the reality of a world divided into different legal systems and myriad business structures and insolvency scenarios, modified universalism seeks to achieve global collective processes with efficient levels of centralization of insolvency proceedings'.*[21] There are cases where more than one proceeding may benefit the stakeholders and, in such scenarios, modified universalism becomes the ideal tool. Sir Roy Goode mentions that '*some leeway is also given to the concept of territoriality to accommodate the legitimate expectations of local creditors in relation to local assets. Thus, the opening of territorial proceedings is permitted in a State where the debtor has an establishment or assets . . . '*[22] Both UNCITRAL MLCBI and EU Insolvency regulations are premised on the principles of modified universalism. Modified universalism is often perceived as an amorphous concept that is a broad principle and not actually a rule.[23] It has become a general trend because there exists drastically increasing recognition of the difficulty to control cross-border insolvency cases efficiently solely by relying on the domestic private international laws of the countries.

Since insolvency law stands on a very different pedestal, engaging both public and private interests, it has been rightly termed as a 'meta-law'.[24] It has demanded attention from both public and private person's point of view because as much as it has been considered a procedural law, *'insolvency principles are closely linked to fundamental public policy and social goals, and insolvency outcomes can impact the economy and the wider public…'*[25] With the rise of multinational companies and increasing interconnectedness of business and daily lives, countries have come to realise that territorialist approach to cross-border insolvency cannot sustain in the long run. It is clear from insolvency cases of giants such as *Hanjin Shipping*[26], which was the seventh largest cargo carrier in the world. The insolvency proceedings began in South Korea and swift recognition of proceedings of South Korea by other countries was imperative to the interests of the concerned countries (public interest) so that the halted cargos could recommence movement to different destinations as required.

The informality and flexibility are what makes modified universalism a popular option for legislators and academicians alike. Its gradual development and non-imposing modesty have attracted a lot of countries towards it[27]. Apart from the UNCITRAL MLCBI[28], insolvency protocols and cooperation among courts of different countries are testimonies to the widespread acceptance received by modified universalism. With or without the MLCBI, courts have adapted to the notion of modified universalism through the application of comity as is clear from the observation noted in *Galbraith v. Grimshaw*[29], that *'....it is quite consistent with the comity of nations that it should be a rule of international law that if the Court finds that there is already pending a process of universal distribution of a bankrupt's effects it should not allow steps to be taken in its territory which would interfere with that process of universal distribution'.*

Though modified universalism has received a nod from most countries, its applicability remains uncertain. For instance, UK, of late, has been applying modified universalism narrowly as is evident from the case of *Rubin v. Eurofinance*[30] and by the application of Gibbs rule[31] in insolvency and restructuring cases, UK law applied choice of law rules of contract law in the context of insolvency proceedings. Through the application of Gibbs rule, the UK restricted the enforcement of orders that were not agreeable under its domestic law. In the case of In *re OJSC*[32], the UK court refused to grant a permanent stay that would aid the enforcement of a restructuring plan approved by a foreign court in Azerbaijan[33]. The court held that MLCBI only guides path for procedural aspect of insolvency and does not include any rules pertaining to the choice of law, leaving substantive rights of creditors to be determined by domestic law of the country or the chosen law, as the case may be, and the same cannot be surpassed by triggering provisions for relief under the Model Law. The UK courts have also observed in Rubin that, *'the specific forms of cooperation provided by Article 27 do not include enforcement. Indeed there is no mention anywhere of enforcement yet the guidance clearly had it in mind. On the other hand, cooperation 'to the maximum extent possible' should surely include enforcement, especially since enforcement is available under the common law....*[34]*'* thereby expressing doubt over the extent of applicability when MLCBI is applied. These decisions are heavily criticised.

In an attempt to promote universalism and widescale adoption, provisions of MLCBI and MLIJ are widely worded allowing territoriality and domestic laws to creep in wherever there are cracks in interpretation. Prof. Mevorach observes in this context that, *' ..the rather imprecise legislative framing of the relief provisions in the MLCBI, especially concerning the enforcement of judgments, might have contributed to territorial choices of courts and the inconsistent application of the framework in different jurisdictions...'*[35]

Where the benefits from following universalism are less apparent, countries may be reluctant to cooperate when they do not see any immediate gain from it. Prof. Mevorach exemplifies it, '*...courts that are asked to turn over assets to a main process abroad, to the frustration of local creditors, may observe a concrete loss today, while longer term benefits of reorganization, increased international trade, certainty, and so forth are more ambiguous and harder to quantify*'.[36] This approach is clear from the observation made by the apex court of UK in *Rubin v. Eurofinance*[37] '*the introduction of judge-made law extending the recognition and enforcement of foreign judgments would be only to the detriment of UK businesses without any corresponding benefit..*' This approach, through criticised, makes MLCBI uncertain in cases where countries do not appreciate the long-term gains from cooperating with other countries.

The MLCBI and MLIJ are not a packaged deal. While 49 countries have adopted the MLCBI, not all have adopted MLIJ so far. As mentioned above, MLIJ is a stand-alone instrument that is meant to be adopted independently as well even though there are cross-references to MLCBI in the text of MLIJ. This shrinks the universal reach of MLCBI, attempted to be achieved through the MLIJ. The former Model Law does not establish any jurisdiction rules of universal application, nor does it establish choice of law on the basis of determination of COMI. In fact, COMI's purpose extends to recognition of proceedings, not for enforcement. The MLIJ, by avoiding reference to significant terms that are used throughout the MLCBI, makes its application ambiguous instead of developing more appeal because those countries that may adopt MLIJ without adopting MLCBI may end up refusing enforcement of insolvency judgments passed in main proceedings if there is no submission by parties[38] or where it does not recognise the concept of COMI.

The preamble to the MLIJ, though not putting adoption of MLCBI as a pre-condition established that MLIJ can be used to complement the MLCBI[39]. However, it is fraught with inconsistencies and has overlapping but unidentical set of goals to achieve. This affects its smooth adoption and consequently modified universalism.

The goal of MLCBI is to achieve universalism or near-universalism. It falls short on that promise because it is not clear on the guiding the enforcement and effectuating of the judgments, leading even countries such as USA[40] and UK[41] to an inconsistent path.

Whether a country has adopted MLCBI or not, if the concept of COMI has been used (e.g. EU) in the law to initiate the proceedings as part of universalism/modified universalism, the determination would often be uncertain and ambiguous. Moreover, the COMI can be easily manipulated by multinational enterprises by changing registered place of business, place of incorporation, principal place of business. Prof. LoPucki has given set of examples to demonstrate this:

> Regardless which characteristics of a company determine a multinational's COMI, the multinational can easily change them. [For instance] Dreco Energy, which moved both its headquarters and center of operations from Canada to the United States in contemplation of bankruptcy; Singer N.V., which moved its headquarters from Hong Kong to the United States in order to file bankruptcy here; Commodore, which moved its headquarters and place of incorporation from the United States to the Bahamas for tax reasons before filing bankruptcy there; and BCCI, which moved its headquarters from London to Abu Dhabi before filing bankruptcy at its place of incorporation in Luxembourg…[42]

Forum shopping thus becomes a common malpractice in both universalism and modified universalism.

At present, what international insolvency law lacks are a) choice of law rules and b) asset tracing rules that can fortify the present sets of Model Laws provided they receive more acceptance than at present. Choice of law rules are imperative because they aid in the domestic country's understanding of the law applicable at the time of considering application for recognition. If there is clarity on which law applies in main and non-main proceedings, predictability is enhanced manifold. It will also bring uniform treatment of creditors across jurisdictions, a step in the direction of 'true universalism'. EU Insolvency Regulations establishes *lex fori concursus*, i.e., law of the main proceeding/forum[43] shall apply, bringing certainty to the choice of law. Inspiration can be sought from these regulations too. UNCITRAL is yet to deliberate in detail on this issue but has flagged it in the past[44], giving universalism a ray of hope.

Universalism requires a single sovereign's court to issue orders that will apply across countries and in effect, the orders of one nation will automatically prevail in other sovereign nations.[45] This compromises the sovereignty of compliant nations. It is often said that universalism can't be instituted without '*a comprehensive insolvency convention or global courts and centralized enforcement mechanisms'.*[46] On the other hand, universalism creates uniformity in the treatment of creditors across jurisdictions whether that jurisdiction had COMI or not. Information asymmetry is reduced and the chances of restructuring increase. The proponents of universalism believe that only a unified single proceeding can facilitate that assets be assembled to be sold / recapitalised free of prior claims and value be allocated fairly to all the stakeholders of a CD.[47] However, the nation's accepting universalism or its mellowed down version are concerned that about the prisoner's dilemma wherein they allow other sovereign nation's law to prevail on their domestic land while other nations may not extend the same courtesy, leaving the accepting nations vulnerable. Also, if the other nations that the accepting nations trade with, continue with territorial approach, the accepting nation's approach diminishes in value because cooperative agreements can't be reached[48] and their cooperation can't reach fruition. In fact, that is why the accepting nations have been influencing and acclimatising their neighbouring nations and nations that they have trade relations with their own versions of universalism.[49]

From the perspective of less developed/underdeveloped countries, universalism can be a mode of imposition of developed country's law on their domestic land, a way of controlling their domestic assets and lands.[50] Most underdeveloped countries have been colonies of a developed nation. The fear of being enchained again can't be over emphasised. Since most multinational companies have their places of incorporation/principal place of business/headquarters in developed countries, the bankruptcy of such multinationals, under universalism, would be filed in the developed country, who can then dictate orders in the lands of underdeveloped countries, making their sovereignty vulnerable.

Cooperative territorialism acts as a soother for those nations who fear compromising sovereignty / losing control by making applicable the laws and orders of foreign courts. Cooperative territorialism offers limited but much-needed cooperation to bring forth insolvency resolution and liquidation of assets. In the absence of such cooperation, the multinational companies can make such countries asset havens for themselves. In cooperative territorialism, the Adjudicating Authorities exercise jurisdiction and administration over local assets of a company, branch or office, subsidiary while cooperating with other countries based on mutual agreements. Prof. LoPucki[51] explains it, '*each of the bankruptcy courts would assume jurisdiction over the local assets…would determine whether to cooperate in a multinational reorganization or liquidation…and in the event of liquidation, each would distribute the assets of the company among creditors and shareholders under local laws…*' Prof. LoPucki points out five main areas where cooperation can be concluded while following territorialism , these are : (a) procedures to file claims by creditors in other countries simultaneously with the original country where bankruptcy has been filed; (b) information sharing regarding claims to prevent double claims; (c) increasing liquidation value by combined sales where separate sales would fetch less value; (d) seizure and return of local assets if subjected to fraudulent or other avoidable transactions/sales; and (e) participating in reorganisation process taking place in another country by local creditors.

Cooperative territorialism brings more certainty to creditors who lend expecting that the local law of that country will prevail, unless expressly mention to the contrary. This dilemma of creditors' expectation in territorialism is explained by US court as follows:

> In calculating expected economic benefits, parties are assumed to take into account the legal systems and rules that will likely govern how their transactions are carried out and the benefits are allocated. In addition, the parties must evaluate the risks undertaken, including how these risks will be handled under the applicable legal system. If it is uncertain what legal system will govern the risks, it is difficult to quantify them. Where the distribution rules of legal systems are different, the ultimate beneficiaries of transactions may differ from those the parties have anticipated ex ante. Thus the application of varying distribution rules may result in the parties' entering into sub-optimal transactions, and leave them poorer...[52]

Cooperative territorialism provides some relief to the creditors by providing certainty. Therefore, it is more predictable and followed by most countries.[53] Several countries met out same treatment to creditors standing at the same pedestal, irrespective of their nationality, place of incorporation, etc., e.g. India.[54]

Cooperative territorialism is, however, faced with a discouraging economic reality- the increased cost of insolvency resolution because of parallel, simultaneous local proceedings that take place in every country. Furthermore, the restructuring process under insolvency resolution becomes difficult & costly to materialise because coordination with each court would not only make the process expensive and cumbersome but also time consuming and ineffective because it would reduce the overall value of the project. Several other disadvantages have been brought forth in the following paragraph:

> reorganization is much more difficult to achieve ....because it decreases liquidation values and makes coordination of cases extremely complex. ...conflicts between jurisdictions and courts can easily develop....creditors cannot know in advance where the debtor's assets will be located when bankruptcy intervenes, which causes a less efficient ex ante allocation of capital....distribution results are both uneven, violating the bankruptcy principle of treating similarly situated creditors equally, and unpredictable, increasing the cost of capital... under territorialism, both the debtor and individual creditors can engage in strategic behaviour to advance their private interests at the expense of the general interests of [all] creditors.[55]

Since following territorialism by countries may lead to increased costs, 'disparate treatment of similar creditors', and a high level of necessary creditor cooperation[56] leading to many inefficiencies in the process, cooperative territorialism steps in to provide limited cooperation that allows countries to enjoy their sovereign status freely.

In essence, cooperative territorialism promises continued application of local laws with sufficient scope for coordination and cooperation. The cooperation may be in the form of case-specific protocol or general mutual agreements between countries with trade relations. Although critics may point out the uncertainty cooperative territorialism brings, the same also exist in case of modified universalism. Modified universalism also stations itself on the premise of cooperation based agreements and protocols. So, difference in such a case is hardly present.

Following is a comparative table for cooperative territorialism and modified universalism that culminated the features of both schools of thought:

Table 1: Cooperative Territorialism Vs. Modified Universalism

Issue	Cooperative territorialism	Modified universalism
Nature of proceeding	All proceedings are of same status, i.e. equivalent to main proceedings.	Proceedings would be main and ancillary proceedings. Country in which COMI is situated would organise main proceedings.
Application of law	Local law applies with few exceptions.	Limited application of local law.
Jurisdiction	Jurisdiction is asserted over local assets. Adjudicating Authority enjoys complete jurisdiction.	Country may not have jurisdiction if sufficient local assets are not present, or if so decided in main proceeding.
Reach to assets	Only local assets can be utilised in the proceedings to satiate the claims of creditors.	Local as well as international assets are available to satiate the claims of creditors
Value of assets	Since only local assets are used, liquidation value of company is often lower.	Since an international pool of assets is created, liquidation value is often higher.
Protection to creditors	Creditors are assured that local law will apply. The respite is generally limited to local creditors. Creditors would be free to apply to foreign courts for unsatiated portion of claims.	Creditors can expect application of local laws, but no certainty. Respite is available to all creditors alike, barring few exceptions.
Protection to other stakeholders	All other stakeholders are protected as per local law of insolvency. Certainty and predictability present.	All other stakeholders expect application of local law but no certainty.
Determination of COMI	Not required.	Required in most jurisdictions
Right to refuse application of foreign order/law	It is assumed that foreign order/ law will not apply to the local assets unless otherwise agreed upon through agreements.	It is assumed that the foreign order of main or ancillary proceeding will be enforceable unless expressly refused. E.g. -under MLCBI, a country can refuse to honour the foreign order on grounds that it is unfair to local creditors.
International cooperation	International cooperation is achieved through protocols and bilateral & multilateral agreements.	International cooperation is achieved through protocols, bilateral and multilateral agreements and through adoption of Model Laws.
Forum shopping	Forum shopping by multinational enterprises not possible.	Forum shopping by multinational enterprises possible by shifting COMI.

Issue	Cooperative territorialism	Modified universalism
Restructuring of multinational enterprises	Restructuring of MNEs cumbersome, expensive, time-consuming and uncertain.	Restructuring of MNEs is coordinated, less expensive, efficient and more certain.
Applicable procedures	Procedures under the local laws will apply.	No certainty as to the applicability of procedures. Local procedures Amy or may not apply.
Need for local insolvency resolution professionals	Local Insolvency Resolution Professionals are required for local proceedings.	Local Insolvency Resolution Professionals may not be needed or their role may be minimal.
Surplus proceeds	Surplus proceeds are distributed among the local stakeholders unless mutual agreement provides otherwise.	Surplus proceeds are transferred to the main proceedings to be distributed to other international creditors/ stakeholders.
Multiple parties/ countries	Difficult to achieve cooperation when multiples parties/countries are involved.	Easier to achieve cooperation when multiple parties/cooperation is involved.

As is amply clear from the above table, cooperative territorialism offers more certainty and predictability with a compromise on the liquidation value. Methods and scope of cooperation and coordination among countries remains negotiable and unpredictable under both theories.

At this point, when steps, modes and nodes of modified universalism remain undefined, cooperative territorialism looks like an attractive approach that brings more certainty in comparison (at least in terms of applicability of local laws). Model Law of UNCITRAL (MLCBI), which is by far the most popular form of modified universalism (adopted by 49 countries) also reflects aspects of territorialism.[57] Both theories endorse achieving economic efficiencies. Both theories depend on the coordination and cooperation of adjudicating authorities, *alibi* at different levels. Judicial cooperation may be more forthcoming in modified universalism than cooperative territorialism, but the success of both shall depend on the discretion of the judges, an uncertain and subjective factor. As much as in modified universalism, willingness to cooperate and economic analysis as to the liquidation value (whether more if local assets combined with international assets) are matters that are left to the judge's comprehension, in case of cooperative territorialism. This is an arbitrage that cross-border insolvency law is born with. An unregulated universalism can lead to forum shopping, but it can also lead to more cooperation when multiple parties are involved.

CONCLUSION

Cross-border corporate insolvency is one of the most complex problems of the commercial law in present times. It has been aptly put that *'no aspect of human endeavour is more clearly global than commerce & investment and no part of commercial law has been more in the forefront of international cooperation than the law of insolvency...'*[58] Most scholars believe that an insolvency law treaty would be the ideal solution for bringing in pure universalism in the global arena.[59] However, we can't deny the ground reality that mature jurisdictions such as UK, USA and EU have propagated UNCITRAL MLCBI but have failed to truly adopt modified universalism consistently nor any of these jurisdictions have adopted MLCBI as a whole. Most mature jurisdictions have formulated their own insolvency law to deal with cross-border issues that have reflections of MLCBI but none have adopted in full. At this time when both consistency and intention are in question, India need not be influenced by countries it has trade relations with. As long as the basic tenets of international insolvency law are honoured, India has the unique freedom to formulate its own law that honours its own domestic insolvency law and commitments of the Constitution. As was reiterated by the Insolvency and Bankruptcy Board of India –

> substantial increase in India's economic interaction with the rest of the world over the last three decades and deepening of the financial markets provide enough evidence for having a robust cross border regime in the country. Rising graph of FDI and significant increase in cross border mergers and acquisitions create background for taking all the necessary steps for bolstering investors' confidence.[60]

At this juncture, instead of following footsteps of other countries who have continued to aggressively influence the domestic commercial laws, India can carve its own path. It can adopt cooperative territorialism that will protect its sovereignty (which is crucial as learnt from the Russian-Ukraine conflict) and provide cooperation at the same time. The Adjudicating Authorities and Insolvency Resolution Professionals in India are at being moulded at present and should be trained to handle complex international insolvency law cases. Procedures of domestic insolvency law should be reflected in international insolvency cases too, in order to maintain consistency and predictability. MLCBI is incomplete in itself and will require adoption of the Model Law on group insolvency and MLIJ to enforce judgements. These Model Laws are often overlapping and may require thorough blending, editing and amendments to be adopted with the other. Given that MLCBI is not the ultimate law that provides all answers to the problem of cross-border insolvency cases, why not formulate an indigenous law for India that other nations can absorb and adopt. After all, India is an attractive destination for foreign investment and foreign trade. Countries, both developed and others, would like to align themselves to benefit from relations with India. Time is ripe and appropriate for India to give other countries principles that they can draw inspiration from.

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THE COVID-19 (MISCELLANEOUS PROVISIONS) ACT 2020:

TO CURB REPERCUSSIONS ON THE FINANCIAL SECTOR (BANKRUPTCY AND INSOLVENCY)

—Rajendra Parsad Gunputh

Executive Summary

In order to administer a legal blow to the COVID-19 pandemic disease, the COVID-19 (Miscellaneous Provisions) Act 2020 was introduced by the Mauritian Parliament to curb repercussions on the financial sector and various sectors, key in the development of the Mauritian economy and its socio-economic development, irrespective it is in the public or private sector. As a result, some 57 legislations (The Insolvency Act 2009, The Financial Services Act 2007, The Bank of Mauritius Act 2004, The Income Tax Act 1995, The Data Protection Act 2017, The Foundations Act 2012, The Limited Liability Partnerships Act 2011, The Limited Partnerships Act 2011 and The Workers' Rights Act 2019) were amended promptly to address the challenges and impact posed by the pandemic disease in a time of chaos, uncertainties and complexities in Mauritius and worldwide. These measures are temporary only for the time, the Mauritian Government would redress the financial economy of the small island State in the reorganisation, their internal organisation and administration, and for the Registrar of Companies to issue relevant and important practice directions, or guidelines for the proper application of the these amended legislations. Various facilities were administered to prevent any additional impact on these sectors, and to restrict the number of, *inter alia*, voluntary winding up, bankruptcy and insolvency among companies. These amended legislations also bring also a new social environment for workers and employees to work from home (WFH), more flextime, payment of overtime in connection during the COVID-19 period or to prevent them to become redundant. In return, human rights activists complained on restrictions imposed on, *inter alia*, freedom of movement, freedom of expression or limitations on gatherings, and other restrictions on associations and assembly.

Keywords: The COVID-19 (Miscellaneous Provisions) Act 2020, Bankruptcy and Insolvency, Human Rights

INTRODUCTION

The COVID-19 pandemic creates disorder, frictions among corporates and turmoil in all financial and business sectors worldwide without any exception. Consequently, various important sectors had to, *inter alia*, wind up, become bankrupt and have to close up provoking additional financial stress on a damaging economy with harm done in public health with waves of infections. The aim and objective of this contextualised paper is to discover the Mauritian approach and how the Mauritian Government tries to enhance socio-economic development in key sectors; such as textile, manufacturing sectors, food, tourism, retail, wholesale and agriculture with a direct impact of Mauritian economy and finance, and, consequently, on its GDP, which contracted by 11% in 2020 according to the International Monetary Fund; to relaunch promptly its various sectors to avoid bankruptcy, unemployment and winding-up of companies. In its mixed system with legislations borrowed from England and France principally, the Mauritian legislator passed urgently the COVID-19 (Miscellaneous Provisions) Act 2020 and the Quarantine Act 2020[1] with an additional set of legislations, as tabled, despite there were protest from human rights observers due to various restrictions and limitations.

As an illustration, and like many countries, the small Republic of Mauritius, as a member of the United Nations Development Program (UNDP) is committed to the 17 Sustainable Development Goals (SDGs) which have been set up by the UNDP in order to '*protect the planet, to eradicate poverty and ensure that all people enjoy peace and prosperity*' to be achieved by 2030. To achieve these SDGs, the Mauritian legislator passed the Equal Opportunities Act 2008, the Employment Relations Act 2008 (Act 32/2008) and the recent Workers' Rights Act 2019 (Act 20/2019) to reduce inequality, to protect all workers against victimisation and discrimination on the workplace. The new Workers' Rights Act 2019 (Act 20/2019) came into force, and it also provides sufficient provisions to promote decent work and economic growth through sustained economic growth, higher levels of productivity and technological innovations as per the SDG 8. The Preamble of the Equal Opportunities Act 2008 enacts that the act was passed to, '*Promote equal opportunity between persons, prohibit discrimination on the ground of status and by victimisation, establish a Commission and an Equal Opportunities Tribunal and for related matters*'.

Table 1: The Mauritian Legislations and its Adaptability on Some Human rights Issues

1	The COVID-19 (Miscellaneous Provisions) Act 2020	16	The Government Wage Assistance Scheme
2	The Prevention and Mitigation of Infectious Disease Coronavirus Regulations 2020	17	The Self-Employed Assistance Scheme.
3	The Public Health (COVID-19 Vaccines for Emergency Use) Regulations 2021	18	The Additional Remuneration and Other Allowances Regulations 2019
4	The Quarantine Act 2020	19	Constitution of Mauritius 1968
5	The Quarantine (COVID-19) Amendment Regulations 2021	20	The Employment Relations Act 2008 (Act 32/2008)
6	The Work from Home Regulations 2020	21	The Employment Relations (Amendment) Act 2019
7	The Worker's Rights (Additional Remuneration) Regulations 2021	22	The Equal Opportunities Act 2008

8	The Workers' Rights (Extension of Time During COVID-19 Period) Regulations 2020	23	The Industrial Relations Act 1973 (repealed)
9	The Industrial Court Act 1973	24	The Workers' Rights 2019 (Act 20/2019)
10	The Occupational Safety Health and Welfare Act 1988	25	The Occupational Heal and Safety Act 2005
11	The End of Year Gratuity Act 2001.	26	Public Bodies Appeal Tribunal Act 2010
12	Public Service Commission (PSC) Act	27	The Protection of Human Rights Act
13	The Registration of Association Act 1979	28	The Workers' Rights (Payment of Special Allowance 2021) Regulations 2020
14	The Public Health Act 1925	29	The Workers' Rights (Extension of Time during COVID-19 Period) Regulations 2020
15	The Code Civil Mauricien, The Code de Commerce Mauricien and the Code Pénal	30	The Public Gathering Act

However, though the COVID-19 pandemic is under control in the small island of Mauritius with its 1.3 million inhabitants, it has, nevertheless, impacted very negatively on the workers' rights in various ways through quarantine, lockdowns, restrictions on movement, personal liberty, and freedom of expression and freedom of association and assembly just to name a few. For the first time and inadvertently workers started to discover new legislations and regulations such as the Prevention and Mitigation of Infectious Disease Coronavirus Regulations 2020, which imposed a curfew order of 21 days to contain the spread of the COVID-19 pandemic in Mauritius, and any breach would entail any person to a term of imprisonment of a maximum term of six months and a fine of ₹ 5,00,000. Unexpectedly, as it was urgent for Parliament to pass these amendments, the COVID-19 (Miscellaneous Provisions) Act 2020 amended a broad array of 56 existing primary enactments with a view to save corporates from insolvency but this paper will focus on amendments brought to the Companies Act 2001, the Insolvency Act 2009, the Interpretation and General clauses Act 1974, the Financial Services Act 2007, the Bank of Mauritius Act 2004 coupled with various amendments which have been brought to the employment law so that all workers, employees and employers in all sectors to adapt themselves to the 'new normal' as per the amendments brought to be in line with the requirements and needs of the population as Mauritius became a centre for double taxation avoidance agreements (DTTA) with more than 55 countries including India and export, import, doing business, commerce and trade attracting foreign workers to work in its industries and factories with export of textile to the USA under the African Growth and Opportunity Act (AGOA). Through these legislations and amendments brought, the gist of this paper is to clarify the Mauritian approach but these are temporary measures to curb the repercussions of the COVID-19 on different fronts with special reference to the corporate, insolvency, banking, regulatory and employment to better understand how countries, outside India, have to cope with new measures so that corporates may have adequate time to reorganise themselves promptly to avoid further disruptions in terms of , *inter alia*, bankruptcy and insolvency.

Like elsewhere, the COVID-19 has a huge impact on, *inter alia*, workers and employees in Mauritius with changes on the workplace: restrictions to movement and impact of freedom of speech and expression, vaccination became imperative and compulsory for workers to have access to their workplace even if there are complaints (people suffering from allergies), workers need a work access permit (WAP), the lockdown provoked redundancy and loss of employment in most sectors, loss of remuneration and lay-offs, gender inequality also was detected (women have to work at home and to look after their children and elderly persons in the absence of any maid) and health officers and other employees are front liners working in very strenuous conditions.

New legislations (Table 2, *infra*) were passed by the Mauritian parliament and came into force but there are still hot debates and will be subject of discussion during this conference. Therefore, this conference is an ideal platform for discussion and to debate on the impact of some legislations and regulations which came into force in 2020 and 2021 in Mauritius recently when the population was not prepared to such laws. The COVID-19 (Miscellaneous Provisions) Act 2020, passed on May 15, 2020, amended a very broad array of 57 existing primary legislations, and the new Quarantine Act 2020 replaced the Quarantine Act 1954. The paper highlights the situation prevailing in the small Republic of Mauritius with its 1.3 million inhabitants, its legislations and the new legislations which were passed essentially to avoid any further risk of resurgence of the disease which will put a heavy strain on the country's heath service and economy whilst its key sectors (tourism, financial and economic sector) were already heavily affected with the impact of the COVID-19. The new legislations[2] (Table 3, marked **infra*) impacted on most fundamental rights as the health and security was a priority and as emergency measures to circumvent the spread of the COVID-19 pandemic. In Mauritius, the Constitution 1968[3] in its Chapter II (Table 1) provides for the most basic important fundamental rights, which are directly inspired from, *inter alia*, the Universal Declaration on Human Rights 1948 and the European Convention on Human Rights 1950. The Republic of Mauritius has signed and ratified international covenants (International Convention on Civil and Political rights, International Convention on Economic Social and Cultural Rights, International Labour Convention or The Universal Declaration of Human Rights) and international organisations to which it is a Member State (World Health Organisation). With infringements to fundamental rights, there were restrictions to movement all over the island and most, if not all, companies were closed provoking a halt to the socio-economic development of the island in, *inter alia,* all sectors, offshore companies, national companies causing a complete disruption in the financial hub with loss of, *inter alia*, employment, revenue, and frustrations in the country.

Table 2: Constitution: Chapter II on Fundamental Rights (Sections 3-16)

Sections	Human Rights
Section 3	Right to life and Right to personal liberty
Section 4	Right to life
Section 5	Right to personal liberty, right to be informed of the reasons for one's arrest or detention (section 5(2)); right, after arrest or upon being detained, to be afforded reasonable time facilities to consult a legal representative of one's own choice (section 5(3)); right, after being arrested or detained, to be brought without undue delay before a Court of law (section 5(3))
Section 6	Protection from slavery and forced labour
Section 7	Protection from inhuman treatment
Section 8	Protection from deprivation of property
Section 9	Right to privacy of home and other property

Section 10	Right to a fair hearing (section 10(1)), right to be tried by an independent and impartial court (section 10(1)), right to be tried by a court established by law (section 10(1)), right to be considered innocent until proved guilty (section 10(2)(a)), right to be informed, as soon as reasonably practicable, in a language which he understands and in detail, of the nature of the offence (section 10(2)(b)), right to be given adequate time and facilities for the preparation of his defense (section 10(2)(c)), right of the person charged to defend himself in person (section 10(2)(d)), right to defend himself at his own expense, by a legal representative of his own choice (section 10(2)(d)), right to defend himself, where so prescribed, by a legal representative provided at the public expense (section 10(2)(d)); right to be afforded facilities to examine, in person or by his legal representative, the witnesses called by the prosecution before nay court (section 10(2)(e)); right to obtain the attendance and carry out the examination of witnesses to testify on his behalf before the court on the same conditions as those applying to witnesses called by the prosecution (section 10(2)(e)); right to have without payment the assistance of an interpreter if he cannot understand the language used at the trial of the offence (section 10(2)(f)); right to be present at his trial (section 10(2)); right to obtain within a reasonable time after judgment, upon payment of any reasonable fee prescribed by legislation, a copy of the court record (section 10(3)), right to be judged only in accordance with the substantive criminal law in force at the time of the offence (section 10(4)), right after a conviction or acquittal not to be tried a second time for the same offence except where a re-trial is ordered by a court of appeal or review; right not to be tried for a criminal offence where a pardon has been granted, by the competent authority, for that offence (section 10(6)); right not to be compelled to give evidence at the trial (section 10(7))
Section 11	Protection of freedom of conscience
Section 12	Freedom of expression
Section 13	Freedom of association and assembly
Section 14	Protection of freedom to establish schools
Section 15	Protection of freedom of movement
Section 16	Right not to be discriminated against a person on account of race, caste, place of origin, political opinion, colour, creed or sex

These fundamental rights pave the way for human rights in addition to a written Constitution 1968, the supreme law of Mauritius, which provides for the judiciary and its Chapter II for fundamental rights to all individuals in Mauritius coupled with relevant legislations (Protection of Human Rights Act, The Workers' Rights Act 2019, The Equal Opportunities Act, The Public Health Act, The Occupational Health and Safety Act 2005, that have been passed to enhance human rights for all individuals on the small island of Mauritius. However, The Quarantine Act 2020[4], various regulations (The Public Health Regulations and The Prevention and Mitigation of Infectious Disease Coronavirus Regulations and The Additional Remuneration and Other Allowances Regulations 2019), and various schemes (Government Wage Assistance Scheme, Self-Employed Assistance Scheme, and the Work From Home Scheme) came also into force that impacted on workers' rights so that the prevention and spread of communicable diseases in Mauritius was a priority for the Government and its legislator.

Table 3: The Mauritian Legislations and its Adaptability on Some Human Rights Issues

1	The COVID-19 (Miscellaneous Provisions) Act 2020*	16	The Government Wage Assistance Scheme*
2	The Prevention and Mitigation of Infectious Disease Coronavirus Regulations 2020 (PMIDCR 2020)*	17	The Self-Employed Assistance Scheme*.
3	The Public Health (COVID-19 Vaccines for Emergency Use) Regulations 2021*	18	The Additional Remuneration and Other Allowances (2019) Regulations 2019*
4	The Quarantine Act 2020*	19	Constitution of Mauritius 1968
5	The Quarantine (COVID-19) Amendment Regulations 2021*	20	The Employment Relations Act 2008 (Act 32/2008)
6	The Work from Home Regulations 2020*	21	The Employment Relations (Amendment) Act 2013, and The Employment Relations (Amendment) Act 2019
7	The Worker's Rights (Additional Remuneration) 2021 Regulations 2021*	22	The Equal Opportunities Act 2008
8	The Workers' Rights (Extension of Time During COVID-19 Period) Regulations 2020	23	The Industrial Relations Act 1973 (repealed)
9	The Industrial Court Act 1973	24	The Workers' Rights 2019 (Act 20/2019)
10	The Occupational Safety Health and Welfare Act 1988 (repealed)	25	The Occupational Heal and Safety Act 2005
11	The End of Year Gratuity Act 2001.	26	Public Bodies Appeal Tribunal Act 2010
12	Public Service Commission (PSC) Act	27	The Protection of Human Rights Act
13	The Registration of Association Act 1979	28	The Workers' Rights (Payment of Special Allowance 2021) Regulations 2020*
14	The Public Health Act 1925	29	The Workers' Rights (Extension of Time during COVID-19 Period) Regulations 2020*
15	The Code Civil Mauricien (CCM),[5] The Code de Commerce Mauricien and the Code Pénal	30	The Public Gathering Act

And various legislations (Industrial Court Act, Public Bodies Appeal Tribunal Act, Employment Relations Act 2008) also empowered courts to have relevant jurisdictions (Industrial Court, Reviewing Authority, Public Bodies Appeal Tribunal, Employment Relations Tribunal) for workers (The Workers' Rights Act 2019) to matters an disputes courts have to hear, employees and public officers (as per The Public Service Commission Act, and The Public Service Commission Regulation) in a country which has inherited both French Civil Law, English Common Law and legislations, precedents and doctrine which our legislator and courts still inspire from these two countries because of its two successive colonial inheritance, and where there is a strong separation of powers. According to Dentons Chambers[6] in order to prevent companies to become insolvent or at least to reduce redundancy in Mauritius and in an attempt:

> to provide companies with adequate time to re-organise their internal administration and to ascertain compliance with their corporate obligations in the face of the COVID-19 pandemic, this Act introduces the following measures, which are deemed to have come into operation on March 23, 2020. The Act empowers the Registrar of Companies to issue practice directions, guidelines or such necessary instructions for the proper administration of the Companies Act during the COVID-19 period...The frequency and timeframe for holding annual meeting of shareholders during the COVID-19 period has been reviewed by the Act such that meetings are now to be held not later than 9 months after the balance sheet...The Act exempts a director who believes that the company is insolvent from calling a board of meeting forthwith to consider whether a liquidator or administrator is to be appointed by the board...the Act has widened the timeframe for preparation and registration of financial statements by companies (companies shave 9 months (or such further period, which may be determined by the Registrar of Companies, after the COVID-19 period lapses) to prepare their financial statements..

To avoid any disruption in, *inter alia,* the business and financial sector, The COVID-19 (Miscellaneous Provisions) Act 2020 amended the workers' rights in terms of work from home (WFH), flexitime, suspension of payment of night shift allowance, payment of overtime in connection with the COVID-19 period, annual leaves, Portable Retirement Gratuity Fund, offences to combat discrimination, employers cannot terminate any contract of employment and reduction of workers, a worker may enjoy his/her Transition Unemployment Benefit and the Employment Relations Act 2008 (Act 32/2008) has also been amended so that the delay (90 days) for which the Employment Relations Tribunal has to enquire about a labour dispute and make an award has been shortened.

Table 4:

ILO Conventions	Ratification date	Status
C2 Unemployment Convention 1919	02.12.1969	Ratified
C5 Minimum Age (Industry) Convention 1919	02.12.1969	Denounced on 30.07.1990
C7 Minimum Age (Sea) Convention 1920	02.12.1969	Denounced on 30.07.1990
C8 Unemployment Indemnity (Shipwreck) Convention 1920	02.12.1969	Ratified
C11 Right of Association (Agriculture) Convention 1921	02.12.1969	Ratified
C12 Workmen's Compensation (Agriculture) Convention, 1921	02.12.1969	Ratified
C14 Weekly Rest (Industry) Convention, 1921	02.12.1969	Ratified
C15 Minimum Age (Trimmers and Stockers) Convention, 1921	02.12.1969	Denounced on 30.07.1990
C16 Medical Examination of Young Persons (Sea) Convention 1921	02.12.1969	Ratified
C17 Workmen's Compensation (Accidents) Convention, 1925	02.12.1969	Ratified

ILO Conventions	Ratification date	Status
C19 Equality of Treatment (Accident Compensation) Convention, 1925	02.12.1969	Ratified
C26 Minimum Wage-Fixing Machinery Convention (Revised), 1934	02.12.1969	Ratified
C42 Workmen's Compensation (Occupational Diseases) Convention (Revised), 1934	02.12.1969	Ratified
C50 Recruiting of Indigenous Workers Convention, 1976	02.12.1969	Denounced on 02.03.2000
C58 Minimum Age (Sea) Convention (Revised) 1936	02.12.1969	Denounced on 30.07.1990
C 59 Minimum Age (Industry) Convention (Revised), 1937		Denounced on 30.07.1990
C63 Convention concerning Statistics of wages and Hours of Work, 1939	02.12.1969	Denounced on 14.06.1994
C64 Contracts of Employment (Indigenous Workers) Convention, 1939	02.12.1969	Denounced on 08.07.1999
C65 Penal Sanctions (Indigenous Workers) Convention, 1939	02.12.1969	Denounced on 08.07.1999
C74 Certification of Able SeamenConvention,1946	02.12.1969	Ratified
C81 Freedom of Association and Protection of the Right to Organise Convention, 1948	01.02.2005	Ratified
C81 Labour Inspection Convention, 1947	02.12.1969	Ratified
C86 Contracts of Employment (Indigenous Workers) Convention, 1947	02.12.1969	Ratified
C87 Freedom of Association and Protection of the Right to Organise Convention, 1948	01.04.2005	Ratified
C88 Employment Service Convention, 1948	03.09.2004	Ratified
C94 Labour Clauses (Public Contracts) Convention, 1949	02.12.1969	Ratified
C95 Protection of Wages Convention, 1949	02.12.1969	Ratified
C97 Migration for Employment Convention (Revised), 1949	02.12.1969	Ratified
C98 Right to Organise and Collective Bargaining Convention, 1949	02.12.1969	Ratified
C99 Minimum Wage Fixing Machinery (Agriculture) Convention, 1951	02.12.1969	Ratified
C100 Equal Remuneration Convention, 1951	18.12.2002	Ratified
C105 Abolition of Forced Labour Convention, 1957	02.12.1969	Ratified

ILO Conventions	Ratification date	Status
C108 Scafarers' Identity Documents Convention, 1958	02.12.1969	Ratified
C111 Discrimination (Employment and Occupation) Convention, 1958	18.03.2003	Ratified
C137 Dock Work Convention, 1973	30.07.1990	Ratified
C144 Tripartite Consultation (International Labour Standards) Convention, 1976	14.06.1994	Ratified
C150 Labour Administration Convention, 1978	05.04.2004	Ratified
C156 Workers with Family Responsibilities Convention, 1981	05.04.2004	Ratified
C159 Vocational Rehabilitation and Employment (Disabled Persons) Convention, 1983	09.06.2004	Ratified
C160 Labour Statistics Convention, 1985	14.06.1994	Ratified
C175 Part-Time Work Convention, 1994	14.06.1994	Ratified
C182 Worst Forms of Child Labour Convention, 1999	08.06.2000	Ratified

However, the island and its inhabitants had to endure the COVID-19 pandemic which has taken a toll of human life in unprecedented magnitudes across the world with an increase of unemployment rate following closure of business, companies and firms during the lockdown and various pillars (tourism and the finance sector, trade across border, production and supply chains were disrupted). The Mauritian socio-economic developments suffered considerably just like many other countries. The Mauritian Government reacted fast by passing new legislations (marked * at Table 3) urgently with a view to control the COVID-19 pandemic by amending a number of enactments to cater for the impact of the infectious disease, and for matters connected, consequential or related thereto. New legislations (Table 3) were passed to impose restriction of movement of citizens, closure of borders, restriction to freedom of speech and expression, restrictions to freedom of association and assembly,[7] people were placed into quarantine, the Government and the police imposed red zones leading to inactivity and loss of jobs and people became redundant.[8]

It is true that the Mauritian Government passed important new legislations and regulations as important and essential measures were necessary to control the pandemic disease to spread and to cause death, turmoil, disorder, frictions and havoc among the population but they had a very detrimental effect as well on the enjoyment of a number of fundamental rights including right to health and safety and workers' rights (restriction to movement and liberty of individuals with heavy fine of ₹ 5,00,000 and a term of imprisonment for 5 years in case of breach of the law, inequality, exclusion, discrimination or unemployment in all sectors without any exception and among the young and other fresh graduates) in the absence of any proper monitoring of policies and legislations. On the other side, the COVID-19 (Miscellaneous Provisions) Act 2020 came to give relief in some economic and financial sectors, but it also brought important amendments in the Workers' Rights Act 2019 (Act 20/2019) which was not at the satisfaction of most NGOs and other civil societies as these amendments restricted, *inter alia*, civil liberties.

The structure of this paper is that it covers – (a) it covers the problem statement and literature review of this study with particular reference to the small island of the Republic of Mauritius; (b) impact on business, corporations and financial services; (c) impact on micro, small and medium enterprises (MSMEs): legal and regulatory challenges in the Mauritian perspectives; and (d) conclusion and some recommendations followed by a list of references to enhance further development in this study against the repercussion of the COVID-19 on business and finance not only in Mauritius but worldwide so that we are all prepared now to face such challenges against any pandemic which appear so abruptly causing irreversible impacts in most sectors of, *inter alia*, the economy and finance, education, tourism, or health of a country.

THE PROBLEM STATEMENT AND LITERATURE REVIEW

The problem statement of this paper relates to new legislations which came into force recently in Mauritius when the COVID-19 pandemic caused lockdown in Mauritius. Relevant and new legislations (Gunputh R.P. and Jha A. 2009), were passed to make Mauritius a tourist destination and to make it a safe place and country to work attracting billions of dollars annually in its financial sector while exporting goods and services to the South African Development Community (SADC) and the Common Market for Eastern and Southern Africa countries. Very unexpectedly, the COVID-19 pandemic appeared suddenly causing havocs and disorder in the socio-economic development of Mauritius. As usual, the Mauritian legislator reacted promptly in providing flexible measures in most sectors to curb the impact of the COVID-19 on the Mauritian economy. However, the reverse of the medal was that there were very strict measures imposed to all individuals who were not prepared at all to face all these news restrictions but to encourage e-contracts which have a direct bearing on their fundamental rights.[9]

The aims and objectives of this paper are also to enlighten all these financial impacts in the Mauritian legislative case study, and in a country where individuals enjoy civil liberties and all basic fundamental rights as enshrined in the Constitution 1968 in a democratic State with free and fair general election where the rule of law is complied with, coupled with the 'domino effect' as the pandemic shifted from one sector to another until today but, in the overall, whether these new legislations had really impacted on human rights of all workers in the private and public sector becomes a hot debate to be discussed.

And to what extent, especially when the Mauritian Government and all stakeholders on the island want to achieve the 17 SDGs (Gunputh R.P. 2013) and have established the basic minimum labour standards in most of its municipal law, new legislations which were passed to curb the pandemic had on workers' rights must be studied because of public emergency. Save to some exceptions,[10] Article 4(1) of the e (ICCPR) allows the possibility of derogations from international human rights obligations in time of public emergency.[11,12]

As a result, many countries (France, Italy, England, US, China, Germany, Reunion Island, or India just to name a few) have imposed restrictions on movement, expression or right to strike and assembly though it would definitely be detrimental to human rights and other form of abuses. However, some fundamental rights are not absolute rights, and as an illustration, section 15(3)(a) of the Mauritian Constitution, 1968 impose restrictions within Mauritius provided they are in the interest of defence, public safety, public order, public morality, or public health or of securing compliance with any international obligation which shall not be inconsistent with or in contravention of this section.

And important legislations such as the Workers' Rights Act 2019 (Act 20/2019),[13] the Employment Relations Act 2008 (Act 32/2008),[14] the Occupational Safety and Health Act 2005[15] (OSHA 2005), and the Equal Opportunities Act 2008[16] were passed to cater for workers' rights and safety on the workplace. The Mauritian legislator passed a large number of legislations and regulations: The

Quarantine Act 2020 and the Quarantine (COVID-19) Amendment Regulations 2021, the COVID-19 (Miscellaneous Provisions) Act 2020, the Prevention and Mitigation of Infectious Disease Coronavirus Regulations 2020, the existing Public Health Act 1925 and the Occupational Health and Safety Act 2005, or the Work from Home Regulations 2020 to cater for health and safety on the workplace but we will certainly debate on these legislations for its pros and cons on the population in Mauritius with a ‘domino effect’: restrictions on the movement of citizens, vaccination became compulsory to all individual in Mauritius except those who were under 18 but some citizens who were administered vaccines during the vaccination campaign suffered and died in hospitals, professionals like private medical practitioners, dentists, lawyers, architects or job contractors had no access to their workplace; there were restrictions of freedom of speech, expression and even freedom of conscience and religion just to name a few with the fear of being redundant.[17]

IMPACT ON BUSINESS, CORPORATIONS AND FINANCIAL SERVICES

The COVID-19 (Miscellaneous Provisions) Act 2020 came into operation on March 23, 2020 to implement new measures on business, corporations and in the financial services to, *inter alia*, rescue debtors from becoming bankrupt and insolvent by amending the Insolvency Act 2009, the Companies Act 2001, the Foundations Act 2021, the Limited Liability Partnerships Act 2011 and the Limited Partnerships Act 2011. The Bank of Mauritius Act is amended so that it may grant such amount to the Government as the Board may approve to assist it in its fiscal measures to stabilise the economy of Mauritius, invest with the approval of the Board such amount of the official foreign reserves as the Board may determine in any corporation or company set up for the purpose of facilitating economic development and may approve such grant from the special reserve fund to assist the Mauritian Government in its fiscal measures to stabilise the economy of the Republic of Mauritius.

The Companies Act 2001 has been amended so that the Registrar may issue practice directions, guidelines or such other instructions as may be necessary for the proper administration of the COVID-19 (Miscellaneous Provisions) Act 2020, meetings shall be held not later than nine months after the balance sheet date of the company or such further period as the Registrar of Companies may determine, the time frame for preparation and registration of financial statements by companies have also been extended (nine months) and a director is exempted from calling a board meeting if the company is insolvent. The Insolvency Act has been amended so that the amount of the debt required to serve a bankruptcy notice upon a debtor has been increased from ₹ 50,000 to ₹ 1,00,000, and the COVID-19 (Miscellaneous Provisions) Act 2020 has nullified any winding up resolution passed by a company.

The Financial Services Act has been amended so that during the COVID-19 pandemic, the Board of the Financial Services Commission (FSC) may be held by audio and/or virtual communication with resolution made in writing, signed, or assented to by all members the entitled or receives notice of a meeting. These new legislations, such as the COVID-19 (Miscellaneous Provisions) Act 2020, regulate the lockdown, restrictions to civil liberties, movement, freedom of expression and freedom to association and assembly with closure of all businesses on the island and imposition of very strict sanitary conditions and workers not in possession of their vaccination card were refused access to their workplace, and if they were traced and found that they were in contact with other fellow workers who were found positive were immediately placed in quarantine as per the Quarantine Act 2020. The COVID-19 (Miscellaneous Provisions) Act 2020 amended the Workers’ Rights 2019 (Act 20/2019) and introduced new conditions and hours of workers to most workers and employees in Mauritius but which were deployed once more when the small island encourages small and medium enterprises to develop and workers (taxi drivers, retailers or street merchants) in the informal sector had no revenue during curfew, confinement and lockdown and the importance to look for other resources such as foreign direct investment (Gunputh R.P. 2014).

MSMEs: LEGAL AND REGULATORY CHALLENGES IN THE MAURITIUS PERSPECTIVE

The Mauritian International Arbitration Act 2008 (Act 37/2008, or The Foreign Awards (Recognition and Enforcement) Act (Act 35/1961)) which are, in fact, inspired and borrowed from the United Nations Convention on International Trade Law (UNCITRAL) Model Law, The United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG 1980) or The United Nations Convention on The Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and remain among the most important sources of international commercial law in the Mauritian landscape (Power Paul J. (1999).

The UNCITRAL achieved a new milestone in adopting the Model Law on Electronic Commerce and its Articles 15, 16, and 17 on e-contracts[18], in e-commerce and digital trade, is given full recognition and validity as long as States Members to the Model Law ensure that e-contracts are legally binding on the parties. The World Trade Organisation (WTO) saw a new milestone when most countries adopted the Model Law implementing the same model in their legislations like USA (Uniform Transactions Act), India (The Information Technology Act 2000) or Mauritius (The International Arbitration Act 2008) where these legislations provide legal recognition of electronic documents and electronic commercial transaction. Furthermore, the European Union has adopted the E-commerce Directive 2000/31/EC to create a stringent and effective law for electronic commerce in the internet market within its 28 State European members. E-contract, e-trade and e-investment, in any form of e-business, are a booming industry for most MSMEs (Gunputh R.P. 2012), and they need consideration as to its validity and various implications that international virtual contracting may provoke with the channeling of the bulk of goods with virtual shopping malls at the detriment of consumer's rights and their protection for safe electronic transactions (Kaviar H. 2011).

Actually, the Republic of Mauritius is governed by the International Arbitration Act 2008 (Act 37/2008), as amended, which is *sensu stricto* in line with the UNCITRAL Model Law and has signed and ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), and the Mauritian Parliament has enacted the Foreign Awards (Recognition and Enforcement) Act (Act 35/1961) which governed the recognition and enforcement of foreign arbitral awards dissipating some doubts with respect to enforcement of an award which may be set aside by the Supreme Court on the ground that it is contrary to public policy under section 39(2)(b)(ii) of the International Arbitration Act 2008. Irrespective of whether it is international virtual contracting or not, investors who fail to solve their dispute amicably may have recourse to international arbitration as agreed[19] between the parties instead of having recourse to traditional courts which is too often slow and there is a lack of confidentiality. Another important feature of Mauritius international arbitration, as an ideal platform for international virtual contracting, is its mixed system with French civil law whereas traditionally common law countries and statutes do not expressly mention the requirement of 'good faith' in contracting, with the notable exception of the United States with its Uniform Commercial Code 2002 (paragraphs 1-203). Therefore, in addition to its Civil Code there are relevant provisions in various conventions that the Republic of Mauritius has signed and ratified (Vienna Convention on International Contracts for the Sales of Goods-CISG)[20] and which are also expressly available under Mauritian law and legislations in the form of statutes may now be examined (Gunputh R.P. 2009)

True it is that the United Nations adopted in 1980 'The United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG 1980) (Bell Garry F. (2007)', such that its Article 13 is the relevant enactment to deal with E-Contracts and with the sudden growth of e-contract worldwide, the UNCITRAL[21] reacted promptly as to the validity and the legality of e-commerce with digital signatures mentioned in Article 7 of the Model Law after much debates and discussion but to which the Mauritian legislator has implemented in its domestic legislations[22] after the Government of the Republic of Mauritius has signed all relevant conventions[23] and protocols making Mauritius a Model Law jurisdiction[24] in line with international arbitration[25] rules and the New York Convention[26] (Farnsworth A. 1995).

The Mauritian Supreme Court, as the Apex Court, has exclusive inherent and original jurisdiction in international commercial disputes over any award or interim measures passed by the Arbitration Tribunal. However, a perusal of the International Arbitration Act 2008 (Sornum D. and Gunputh R.P. 2013)) clearly provides of domestic arbitration whereas the Supreme Court[27] is empowered, under section 22(1) of the International Arbitration Act 2008, to the recognition and enforcement of interim measures: '*(1) An interim measure granted by an arbitral tribunal shall, subject to this section, be recognised as binding and, unless otherwise provided by the arbitral tribunal, enforced on application to the Mauritian Supreme Court, irrespective of the country in which it was issued* '. This section opens a gateway to any foreign award and its recognition such that the Mauritian Supreme Court (Gunputh R.P. 2014) has power to award interim measures 'irrespective of the country in which it was issued' in contrast to other countries like India where Part I of the Indian Arbitration and Conciliation Act 1996 is inapplicable to an arbitration where the seat is outside India, following what has been said and applied in the recent judgment of the Indian Supreme Court and its full bench (five-Judge Bench of the Supreme Court) in the case of *Bharat Aluminum Company and Ors v. Kaiser Aluminium Technical Service Inc. and Ors* [(2012) 9 SCC 552], and this judgment overruled a set of decisions reached in *Bhatia International v. Bulk Training S.A. and Anr.* [AIR 2002 SC 1432]; *Venture Global Engineering v. Satyam Computer Services Ltd* [AIR 2008 SC 1061] and *Phulchand Exports Ltd v. OOO Patriot* [(2011) 10 SCC 300.]

Would it be safe for the contracting parties to contract online without any precise legislation or protocols on international virtual contracting? Parties to any international virtual contracting must deal with e-contract(s) cautiously taking into account the validity of the electronic signature, whether the parties are of good faith (supra) in a world of change and digital transformation, and the relevant jurisdiction to claim for damages which may amount to millions of dollars in addition to trouble and costs for an international arbitration, which would overshadow the traditional WTO's dispute settlement (Summers Robert S. 1968). There are transfer of money and numerous cases of fraud has been detected and it is always difficult to, *inter alia*, retrace back fictitious transactions and fake bank details, money laundering, bribe or anti-trust among negotiators and swindlers. International virtual contracting has been criticised as there are loopholes in the law and there is no security to protect negotiators online and they are often left at their own risk and perils. With these alarming words an appeal is made to relevant international commissions to come up with safeguards against computer and web and internet crimes. The Mauritian legislator reacted promptly with the promulgation of relevant and important domestic legislations to protect its individuals who are online and penalties to punish violators for cybercrime and cyber-attacks among others.

International virtual contracting (Sim D. 2001) would soon supersede traditional contracting, and the small Republic of Mauritius must be prepared to do 'more with less' that is with digital transformation and transformation in the mindset of people, and in terms of people becoming more digitally literate to face competition so that they are more involved in skills, training, upskilling of people to be prepared for digitalisation in using new software and new technology in a new world of doing business after the COVID-19 pandemic has brought a crisis but crisis also bring new opportunities as more and more people at all levels in all sectors without any exception are going online (Kaviar H. 2011). The Mauritian landscape is bright with relevant legislations that have been passed by Parliament to cater for data protection (Data Protection Act) and that would also cater for sustainable development in the country and enhance human capital to adapt to new soft skills making students more employable, to prepare people and the Government to go to digital transformation for MSMEs to survive or to overcome new challenges in emerging fields (Ström J. 2011) (fintech, agro-technology, health technology and e-care and health, e-commerce, e-business, or e-contract) and sectors (e-MSMEs, health and medicine, e-tourism, e-digital economy or e-circular economy) provided there are relevant government policies with the proper digital platform and metrics to measure whether digital transformation or e-contracts are improving or not but e-contracts would certainly bring additional benefits in terms of trade and business in Mauritius with double taxation avoidance agreement with India and other countries to boost its financial economy (Gunputh R.P. 2013).

And finally, Article 11 of Contract Law of the People's Republic of China recognises e-contract. Rules of Chinese Contract Law are also found in the General Principles of Civil Law (GPCL of 1986). In France, Article 1316-1 of the French Civil Code recognises electronic contract. In the United States, the UC Electronic Signature on Global and National Commerce Act and the Electronic Signatures in Global and National Commerce Act (E-sign Act) also recognise e-contract with model laws such as the Uniform Computer International Transactions Act (UCITA) and the Uniform Electronic Transactions Act (UETA). In the year 2013, the OECD has provided for Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practice across Borders (Gunputh R.P. 2013).

CONCLUSION AND RECOMMENDATIONS

To keep the financial hub alive, and even more vibrant in the Indian Ocean, the Mauritian legislator passed promptly the COVID-19 (Miscellaneous Provisions) Act 2020 with a view to curb repercussions on the financial sector (bankruptcy and insolvency) and to avoid redundancy in views of uncertainties and complexities with the unprecedented COVID-19 and its enormous impact of the socio-economic development of Mauritius that these temporary measures had to be imposed but were not also welcomed by the population as they had to adapt to new situations and circumstances, and new conditions and regulations of work. Actually, the small Republic of Mauritius has financial support from India to boost its economy in a win-win situation and in its public-private-partnership so that all stakeholders are involved and to contribute for a better health and safety economy.

1 The Quarantine Act 1954 was repealed, and The Quarantine Act 2020 came into force, and the purpose for the Act was – '*to provide appropriate measures for the prevention and spread of communicable diseases in Mauritius*'. As an illustration, section 3 of The Quarantine Act 2020 imposes restrictions of entry by aircrafts and ships in Mauritian borders and imposition of confinement at home and closure of business premises.

2 The COVID-19 (Miscellaneous Provisions) Act 2020, The Prevention and Mitigation of Infectious Disease Coronavirus Regulations 2020 (PMIDCR 2020) and The Quarantine Act 2020

3 Chapter II (sections 3 -16) of the Constitution 1968 provides for fundamental rights (Table 2), which are also human rights inspired from the Universal Declaration on Human Rights 1948, The International Covenant on Civil and Political Rights or The International Covenant on Economic, Social and Cultural Rights

4 As per the Quarantine Act 2020, section 3 imposes restriction of entry by aircrafts and ships in Mauritius, imposition of confinement at home and closure of business premises; section 7 enacts the confinement of persons in quarantine facilities and self-isolation. Section 10 provides for a duty to disclose communicable diseases and section 11 provides police powers to enter premises without a warrant and arrest without a warrant.

5 The French Civil Law prevails in Mauritius with relevant articles form the French Code Napoléon, 1804 (now CCM)

6 Mardemootoo S. et al. (2020), "The COVID-19 (Miscellaneous Provisions) Act of 2020 introduced by the Parliament of Mauritius - Amendments and their implications", Dentons.

7 Part IV (sections 29-34) of the Employment Relations Act, 2008 provides for protection of fundamental rights and section 13 of the Constitution, 1968 provides for freedom of association and assembly.

8 *H.Nunkoo v. Mauritius Biscuit Making company Ltd*, 2015 IND 54, where the Industrial Court Presiding Magistrate held that the mere fact that the plaintiff has conceded that the company was facing economic difficulties is not in itself proof that it was facing economic difficulties that the post occupied by the plaintiff should be made redundant.

9 Povrzenic N., (2014), "Interpretations And Gap-Filling Under The United Nations Convention On Contracts For The International Sale Of Goods".

10 Such as inherent right to life (Article 6 ICCPR), prohibition of torture and inhuman treatment (Article 7 ICCPR), prohibition of slavery (Article 8 ICCPR), freedom of imprisonment on ground of inability to fulfill a contractual obligation (Article 11 ICCPR), right not to be subjected to retroactive application of criminal law (Article 15 ICCPR), right to recognition as a person before the law (Article 16 ICCPR) and right to freedom of thought, conscience and religion (Article 18 ICCPR).

11 Section 18 of the Mauritian Constitution 1968 enacts as, '*the law authorizes the taking of measures that are reasonably justifiable for dealing with the situation that exists in Mauritius during that period*', which is in line with Article 4(1) of the International Covenant on Civil and Political Rights (ICCPR).

12 Spagnolo L. (2008), "Opening Pandora's Box: Good faith and Precontractual liability in the CISG", 21 Temple International and Comparative Law Journal.

13 The Workers' Rights Act 2019 (Act 20/2019) contains relevant and important enactments, *inter alia*, against discrimination against workers, minimum age for employment, different works agreement, different types of work agreements, general conditions of employment, equal remuneration for work of equal value, remuneration in specific circumstances, protective order against employers, meal allowance, leaves, end of year bonus, death grant, benefits, termination of agreement and reduction of workforce, gratuity on retirement and at death, protection against violence at work and all important administrative issues as to keeping of records and register of employers.

14 The Employment Relations Act 2008 (Act 32/2008) provides for relevant and important enactments, *inter alia*, on Registration of Trade Unions, Constitution and administration of trade unions, protection of fundamental rights, collective bargaining, labour disputes and dispute settlement procedures, strikes and lock-outs, employment relations institutions, offences and penalties.

15 Inspired from English Common Law, The Occupational Safety and Health Act 2005 (OSHA 2005) protects all employees and employees on the workplace, and failure for an employer to provide hygiene and security on the workplace is a criminal offence.

16 The Equal Opportunities Act 2008 protects any individual against discrimination so that any individual in Mauritius enjoy the same opportunity. The Human Rights Commission was set up to listen any grievance from any individual whose rights have been infringed as per, *inter alia*, Chapter II of the Constitution, 1968 (Table 2), and the important Protection of Human rights Act coupled with other relevant legislations which protect workers' rights on their workplace.

17 The COVID-19 (Miscellaneous Provisions) Act 2020 amended the Workers' Rights Act 2019 so that an employer cannot reduce his/her workforce during the prescribed period (1st June 2020 and ending on 31st December 2020) - *Les Frais de l'Artigiano RB/RN/38/2020*

18 Section 4 of the International Arbitration Act 2008 enacts as, '*Arbitration agreement (1) An arbitration agreement – (a) may be in the form of an arbitration clause in a contract or other legal instrument or in the form of a separate agreement; and (b) shall be in writing. (2) An arbitration agreement is in writing where – (a) its contents are recorded in any form, whether or not the arbitration agreement or the contract has been concluded orally, by conduct, or by other means; (b) it is concluded by an electronic communication and the information contained in it is accessible so as to be usable for subsequent reference; or (c) it is contained in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by the other. (3) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement in writing where the reference is such as to make that clause part of the contract*'.

19 Section 2A, International Arbitration Act 2008 enacts as, '*Extent of Court intervention. In matters governed by this Act, no Court shall intervene except where so provided in this Act*'.

20 The United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG 1980) (adopted on April 11, 1980 entered into force on January 1, 1988) 1489 UNTS 3.

21 Section 2, International Arbitration Act 2008 enacts as, 'UNCITRAL' means the United Nations Commission on International Trade Law.

22 Section 2, of the International Arbitration Act 2008 enacts as, 'International Arbitration Rules' means Rules made under section 198 of the Courts Act for the purposes of this Act and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards Act.

23 Section 2, International Arbitration Act 2008 enacts as, 'New York Convention' means the Convention on the Recognition and Enforcement of Foreign Arbitral Awards signed at New York on 10 June 1958.

24 Section 2, International Arbitration Act 2008 enacts as, 'Model Law jurisdictions' means jurisdictions which have, or have substantially, adopted the Model Law.

25 Supra Note 20

26 Supra Note 21

27 Section 2, International Arbitration Act 2008 enacts as, 'Court' – (a) means a Court in Mauritius; and (b) includes, where appropriate, a body or organ of the judicial system of a foreign State; but (c) does not include the PCA.

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15

FULLY OPERATIONALISING PART III OF THE INSOLVENCY AND BANKRUPTCY CODE:

ISSUES AND CHALLENGES

— *Sumant Batra*

Executive Summary

Approximately 96% Indian micro, small, and medium enterprises (MSMEs) are proprietary concerns. In a way, they are nothing but individuals in another *avatar*. MSMEs carrying out economic activities form a different class within the class of individuals, distinct from personal guarantors to corporate debtor. They lack the sophistication, knowledge and resources to properly address complex insolvency processes. Their treatment in the event of an insolvency has to be provided keeping in mind their distinct characteristics. The insolvency law is meant to provide them a dignified exit and pave way for their continued participation in economy, while enabling recovery of debt by creditors. When notified, the provisions of the Insolvency and Bankruptcy Code, 2016 (Code / IBC) relating to insolvency of partnerships and proprietorships will impact millions of individuals. In their current form, the provisions are likely to offer many challenges in finding an effective resolution of their insolvency. The biggest stumbling block to effective use of insolvency law by MSMEs, like individuals, may be the stigma associated with it in India. Risk taking is a critical part of entrepreneurship. A good entrepreneur venture may fail or succeed. Efforts are needed to educate people so that the society will be forgiving to the unfortunate. The insolvency law framework should be particularly sensitive to the cultural context of shame and stigma associated with the admission of financial failure. It is essential not only to prevent repeat bankruptcies but also to further rehabilitative goals of behaviour modification. A simplified and cost-effective process is needed to address their obligations.

Keywords: Insolvency, Partnership, Proprietorship, Stigma, Counselling

INTRODUCTION

MSMEs form the foundation of the global economy. They account for 99% of all firms, more than 60% of jobs, and more than 50% of sales in most economies.[1] Although the diversity and sheer number of MSMEs make it difficult to properly quantify them and measure their impact, they represent the majority of businesses and are key drivers of employment, economic growth, and entrepreneurship in virtually all economies. The MSME sector forms a highly vibrant and dynamic sector of the Indian economy.[2] The sector contributes significantly to the economic and social development of the country by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital cost, next only to agriculture. MSMEs are complementary to large industries as ancillary units and this sector contributes significantly to the inclusive industrial development of the country. As per the data available with the Ministry of Statistics & Programme Implementation, Government of India, the contribution of the MSME sector in the country's Gross Value Added (GVA) and Gross Domestic Product (GDP) at current prices in 2018-19 is 33.50% and 30.27% respectively.[3]

INDIAN MSMEs - INDIVIDUALS IN ANOTHER *AVATAR*

There is no consistent or universally accepted definition of the term, MSME. Countries and international organisations apply different measures and tools when determining whether an enterprise should be labelled as micro, small, medium, or large. The most common method of distinguishing them from large enterprises being number of employees.[4] This criterion is often combined with other criteria such as sales, investment, or loan size. In India, by definition, MSMEs are small in size and scale. In accordance with the provision of the Micro, Small & Medium Enterprises Development Act, 2006 (MSMED Act), the MSME are classified as (a) a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees; (b) a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed 50 crore rupees; and (c) a medium enterprise, where the investment in plant and machinery or equipment does not exceed 50 crore rupees and turnover does not exceed 250 crore rupees. The new classification has come into effect from July 1, 2020. The earlier criterion of classification of MSMEs under MSMED Act was based on investment in plant and machinery / equipment. It was different for manufacturing and services units. It was also very low in terms of financial limits.

MSMEs operate informally. For a variety of reasons, the promoters of MSMEs forgo formal incorporation or registration of their enterprise and operate without limited liability, a practice particularly common in developing economies. It is estimated that during the period 2015-16, there are 633.88 lakh unincorporated and non- agriculture MSMEs in the country engaged in different economic activities in India, excluding those MSMEs registered under sections 2(m)(i) and 2(m)(ii) of the Factories Act, 1948; Companies Act, 1956; and construction activities falling under section F of National Industrial Classification (NIC) 2008. Out of these 633.88 lakh MSMEs, 608.41 lakh (95.98%) were proprietary concerns while other are unregistered partnerships or other informal entities.[5] Only a handful of MSMEs are incorporated as a company or limited liability partnership. In other words, an Indian MSME is nothing but an individual in another avatar.

INSOLVENCY OF MSMEs UNDER THE CODE

Part III of the Code deals with the insolvency resolution and bankruptcy of individuals and partnership firms. Pursuant to the recommendations of the Working Group on Individual Insolvency set up by the

Insolvency and Bankruptcy Board of India (IBBI), the term 'individuals' in section 2 of the Code was amended by the Insolvency and Bankruptcy Code (Amendment) Act, 2018 and split into three parts: (a) individuals who are personal guarantors to corporate debtors ; (b) partnership and proprietorship firms; and (c) individuals other than (a) and (b).

The Central Government notified the provisions of the Code in so far as they relate to personal guarantors to corporate debtors, w.e.f. December 1, 2019 by way of the notification dated November 15, 2019 (the Notification).[6] The Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 (IRP Rules) and the Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019 (Bankruptcy Rules) were also notified by the Central Government by separate notifications on November 15, 2019, both effective from December 1, 2019. On November 20, 2019, IBBI issued the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 (IRP Regulations) and IBBI (Bankruptcy Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 (Bankruptcy Regulations) by way of separate notifications, also effective from December 1, 2019.

Upholding the vires of the Notification in its judgment dated May 21, 2021 passed in *Lalit Kumar Jain v. Union of India & Ors*.,[7] the Hon'ble Supreme Court held as under:

> 99. The argument that the insolvency processes, application of moratorium and other provisions are incongruous, and so on, in the opinion of this court, are insubstantial. The insolvency process in relation to corporate persons (a compendious term covering all juristic entities which have been described in Sections 2 [a] to [d] of the Code) is entirely different from those relating to individuals; the former is covered in the provisions of Part II and the latter, by Part III. Section 179, which defines what the Adjudicating authority is for individuals is "subject to" Section 60. Section 60(2) is without prejudice to Section 60(1) and notwithstanding anything to the contrary contained in the Code, thus giving overriding effect to Section 60(2) as far as it provides that the application relating to insolvency resolution, liquidation or bankruptcy of personal guarantors of such corporate debtors shall be filed before the NCLT where proceedings relating to corporate debtors are pending. Furthermore, Section 60(3) provides for transfer of proceedings relating to personal guarantors to that NCLT which is dealing with the proceedings against corporate debtors. After providing for a common adjudicating forum, Section 60(4) vests the NCLT "with all the powers of the Debt Recovery Tribunal (DRT) as contemplated under Part III of this Code for the purpose of sub-section (2)". Section 60 (4) thus (a) vests all the powers of DRT with NCLT and (b) also vests NCLT with powers under Part III. Parliament therefore merged the provisions of Part III with the process undertaken against the corporate debtors under Part II, for the purpose of Section 60(2), i.e., proceedings against personal guarantors along with corporate debtors. Section 179 is the corresponding provision in Part III. It is "subject to the provisions of Section 60". Section 60 (4) clearly incorporates the provisions of Part III in relation to proceedings before the NCLT against personal guarantors.
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> 100. It is clear from the above analysis that Parliamentary intent was to treat personal guarantors differently from other categories of individuals. The intimate connection between such individuals and corporate entities to whom they stood guarantee, as well as the possibility of two separate processes being carried on in different forums, with its attendant uncertain outcomes, led to carving out personal guarantors as a separate species of individuals, for whom the Adjudicating authority was common with the corporate debtor to whom they had stood guarantee. The fact that the process of insolvency in Part III is to be applied to individuals, whereas the process in relation to corporate debtors, set out in Part II is to be applied to such corporate persons, does not lead to incongruity. On the other hand, there appear to be sound reasons why the forum for adjudicating insolvency processes – the provisions of which are disparate- is to be common, i.e. through the NCLT. As was emphasized during the hearing, the NCLT would be able to consider the whole picture, as it were, about the nature

> of the assets available, either during the corporate debtor's insolvency process, or even later; this would facilitate the committee of the creditors (CoC) in framing realistic plans, keeping in mind the prospect of realizing some part of the creditors' dues from personal guarantors.
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> 101. In view of the above discussion, it is held that the impugned notification is not an instance of legislative exercise, or amounting to impermissible and selective application of provisions of the Code. There is no compulsion in the Code that it should, at the same time, be made applicable to all individuals, (including personal guarantors) or not at all. There is sufficient indication in the Code- by Section 2(e), Section 5(22), Section 60 and Section 179 indicating that personal guarantors, though forming part of the larger grouping of individuals, were to be, in view of their intrinsic connection with corporate debtors, dealt with differently, through the same adjudicatory process and by the same forum (though not insolvency provisions) as such corporate debtors. The notifications under Section 1(3), (issued before the impugned notification was issued) disclose that the Code was brought into force in stages, regard being had to the categories of persons to whom its provisions were to be applied. The impugned notification, similarly inter alia makes the provisions of the Code applicable in respect of personal guarantors to corporate debtors, as another such category of persons to whom the Code has been extended. It is held that the impugned notification was issued within the power granted by Parliament, and in valid exercise of it. The exercise of power in issuing the impugned notification under Section 1(3) is therefore, not ultra vires; the notification is valid.

A review of the statutory provisions of the Code applicable to the insolvency of individuals makes it clear that the provisions in respect of all the three classes of individuals, including partnerships and proprietorships, are same.

(a) An application to initiate insolvency resolution process in respect of an individual can be filed either by the individual himself or through a Resolution Professional (RP), in accordance with section 94 of the Code, or can also be initiated by a creditor or by a set of creditors, jointly or through a RP, in accordance with section 95 of the Code.

An interim moratorium (as provided in section 96 of the Code) commences 'on the date of the application' in relation to all the 'debts' which shall cease to have an effect on the date of admission of such application.[8] The import of the words 'date of the application' is not clear. Literally speaking, it would mean that the interim moratorium would trigger on the filing of application in the Registry of National Company Law Tribunal (NCLT), which is a unilateral administrative act of an applicant requiring no judicial order by Adjudicating Authority (AA). Interim moratorium is not aimed as a fiction of law provision that would get triggered just on the filing of an application in the Registry of NCLT. Such an interpretation of the words 'date of the application' would amount to curtailing the legal rights of creditors without a judicial order by AA if such application is filed by the debtor under section 94. It can be safely interpreted that an order of interim moratorium would come into effect only when notice is issued by AA on an application filed under section 94 or 95 of the Code and a RP under section 97 is appointed.

(b) RP shall be appointed by the AA in accordance with section 97 of the Code who shall examine the application filed under section 94 or 95, as the case may be, and submit a report to the AA within a period of 10 days of her appointment. A copy of the application shall be provided to RP within 3 days of her appointment.

(c) The RP 'may', in her report, recommend admission or rejection of the application for initiation of insolvency resolution process in respect of the individual. The RP shall provide reasons in support of such recommendation.[9] In the process of preparing her report, the RP shall examine if the application meets the requirements of sections 94 and 95.

(d) When an application is filed by a creditor under section 95, the RP shall provide an opportunity to the individual to prove repayment of debt, i.e., if the debt claimed by the creditor in the application is contested by the personal guarantor.

(e) The AA shall, within 14 days from the date of submission of the report by the RP, pass an order admitting or rejecting the application.[10] The debtor aggrieved by the report submitted by the RP may file objections to such report. The corporate debtor may also seek to be heard by the AA.

(f) If the application is rejected, the AA shall record that the creditor is entitled to file for a bankruptcy petition. The process of bankruptcy is not being discussed as it is not relevant.

(g) If the application is admitted, the AA 'may', on the request of the RP, issue instructions for negotiations to be held between the personal guarantor and her creditors for arriving at a repayment plan.

(h) On admission of the application, the interim moratorium under section 96 shall cease to have effect and the period of moratorium under section 101 of the Code shall commence. The moratorium is applicable till the passing of an order approving or rejecting the repayment plan by the AA or before the expiry of 180 days from the date of admission.

(i) The AA shall, within 7 days of the order admitting the application, issue a public notice inviting claims from the creditors to be submitted within 21 days of issuance of such public notices in accordance with section 102 of the Code and IRP Regulations. A creditor of personal guarantor shall register its claim with RP pursuant to public notice.[11]

(j) Unlike in corporate insolvency resolution process (CIRP), the RP is not required to constitute a CoC in the insolvency resolution process of a personal guarantor. After the claims are verified[12] and registered, the RP shall prepare a list of creditors.[13]

(k) A repayment plan shall be prepared by the individual, in consultation with the RP.[14] The repayment plan may inter alia require the RP to run and manage the debtor's trade or business, realise the assets of individual or administer or dispose of any funds.

(l) The RP shall submit the repayment plan to the AA, along with her report, within 21 days from the last date of submission of claims, with or without consulting the creditors. The RP may recommend that a meeting of creditors is not required. Reasons in support for making such a recommendation shall be provided. If the RP recommends that creditors be consulted in a meeting of creditors, it shall be so stated in the report.

(m) The report of the RP must affirm that the repayment plan is in compliance with any provisions of law for the time being in force and has a reasonable prospect of being approved and implemented.

(n) The meeting of creditors shall be convened and conducted in accordance with sections 107 and 108 of the Code. Creditors who are part of the list of creditors shall have the right to participate and vote in the meetings in accordance with sections 109 and 110 of the Code. Voting share to creditors shall be assigned by the RP.

(o) If a creditor who is invited to a meeting of creditors decides to participate in the meeting it shall forfeit its right to enforce its security interest during the period of repayment plan.[15] There is no express provision in Chapter III (*supra*) similar to section 52 of the Code allowing a secured creditor to exercise an option to stay outside the insolvency resolution process/repayment plan or relinquish its security interest. However, para 13 of Form B of IRP Regulations in which a claim has to be submitted by a creditor *inter alia* requires the creditor to provide details of any security held (including value and date when it was given)[16] and if the claimant is a secured creditor, it is required to exercise its option to forfeit or not, its right to enforce its security during the period of the repayment plan. The details of security interest that are opted to be forfeited or not opted to be forfeited, are also required to be provided in Form B.[17] This, according to Form B, is to enable the RP to determine the voting share as per section 110 of the Code. The contents that may form part of the repayment plan are set out in regulation 17 of the IRP Regulations. A harmonious reading of section 110 of Chapter III (*supra*) and Form B (*supra*) clearly suggests that a secured creditor shall have the right to forfeit its security interest and recover its debt by way of repayment plan or recover its debt by enforcement of its security interest. By deciding not to participate in the meeting, a creditor would be deemed to have exercised the option to stay outside the repayment plan and opted in favour of enforcement of its security interest in accordance with the law. The security interest held by a creditor cannot be made part of the repayment plan without the consent of such creditor.[18]

(p) Where a meeting of creditors is to be convened, the RP is required to give the creditors at least 14 days' notice of such meeting along with copies of the repayment plan, statement of affairs of the debtor, report of the RP and forms for proxy voting.[19] A creditor may participate in the meeting of creditors and vote on the repayment plan in respect of the unsecured debt without forfeiting her right to enforce security interest in respect of the secured debt.

(q) At the meeting of the creditors, the creditors may decide to approve the repayment plan by a majority of more than three-fourth in value of the creditors present in person or through proxy and voting.[20] The RP shall submit a report of the meeting of creditors on the repayment plan to the AA. A copy of the report shall be provided to the personal guarantor and creditors.[21]

(r) The AA may approve or reject the repayment plan or if it deems fit, remand the repayment plan to the RP and direct a meeting of creditors for reconsideration.[22]

(s) If the repayment plan is approved by the AA, it shall be binding on the debtor and creditors.[23] The AA may issue such directions for implementation of the repayment plan as it deems fit.

(t) If the repayment plan is rejected by the AA, the debtor and the creditors are entitled to file an application for bankruptcy of the debtor under Chapter IV of Part III of the Code.

Insolvency of Partnerships and Proprietorship Vs. Insolvency of Corporate Debtor

A review of the statutory provisions of the Code applicable to the insolvency of individuals is significantly different from that of corporate persons, such as:

(a) CIRP proceedings are based on a 'creditor-in-control' legal framework. The insolvency resolution process of individuals is based on a legal framework that does not provide for control or supervision of the insolvency resolution process by the creditors. In CIRP, resolution applicants are invited to submit resolution plan in accordance with the terms decided by the CoC. The provisions allow the debtor to prepare a repayment plan in consultation with the RP, which may be presented for voting in a meeting of creditors who have opted to forfeit their security interest to receive their debt by way of repayment plan. The supervision of the AA is greater in the case of insolvency resolution process of individuals.

(b) The Code contemplates a role for RPs to assist the AA in deciding if the insolvency petition should be admitted or rejected.

(c) Through the provisions for CIRP of a corporate debtor, the Code aims to provide for an insolvency resolution of the corporate debtor by maximising the value of its assets and preventing it from going into liquidation. The maximisation of the value is achieved by approving of a resolution plan for the corporate debtor that is viable and feasible and provides for distribution of proceeds to creditors in accordance with the priorities set out in section 53(1) of the Code, in lines with the objectives of the

Code. In insolvency resolution process of individual, the insolvency resolution is provided by approval of a repayment plan proposed by the debtor herself. The repayment plan, unlike the resolution plan, provides for the payment of debt to the creditors, and discharging the individual after implementation of repayment plan.

(d) In CIRP, the resolution plan is required to be approved by 66% of voting share of members of the CoC. Approval of resolution plan is a commercial and legal prerogative of the CoC. In insolvency resolution process of individuals, the repayment plan is to be proposed by the individual, in consultation with a RP. In individual insolvency, the creditors may decide to approve the repayment plan by a majority of more than three-fourth in value of the creditors present in person or through proxy and voting. In some cases, the repayment plan may not even require to be approved by the creditors.

(e) In individual insolvency, a creditor shall register its claim with RP pursuant to public notice.[24] After the claims are registered with the RP, the RP is required to prepare only a list of (all) creditors whose claim is registered.[25] No CoC is constituted.

In CIRP, all assets of the corporate debtor, including those held as security interest by its creditors, must be pooled into a common kitty so that a resolution of insolvency of corporate debtor can be found and payment of debt of creditors is made in accordance with the provisions of the Code. Distribution to be made to the creditors is to be decided by the CoC taking into consideration the waterfall mechanism provided in section 53(1) of the Code. Creditors are prohibited by section 14 of the Code from taking any legal or enforcement action against the corporate debtor. In insolvency resolution process under Chapter III (*supra*), there is no concept of collective creditors' proceedings for maximisation of value of assets of corporate debtor for the benefit of its creditors and other stakeholders. The purpose of the repayment plan is to make payment of dues of creditors as per the repayment plan and approved by the AA. A repayment plan envisages payment to creditors by liquidation of assets of debtor (a) where security interest in such assets is voluntarily forfeited by the creditors holding security interest therein; and (b) from the assets that are not charged to any creditor. There is no mandatory requirement to seek guidance from the waterfall mechanism in Chapter III (*supra*) similar to that provided in section 30 of the Code in respect of CIRP. Absence of waterfall provision in insolvency process of individuals appears to be primarily because the secured creditors have a right to stay outside the repayment plan in respect of secured debt.

(f) The scope of moratorium in CIRP and individual insolvency process is different. The language of section 96(1) is very different from the language of section 14 of the Code. Interim moratorium under section 96(1) of the Code commences when notice is issued by the AA on an application filed under section 94 or 95, as the case may be. Interim moratorium under section 96(1) of the Code is in relation to 'all the debts' of the debtor. The interim moratorium under section 96(1) of the Code continues till an order is passed (either admitting or rejecting the insolvency petition) by AA under section 100 of the Code. If the insolvency petition is admitted, the interim moratorium will be converted into moratorium under section 101 of the Code.

(g) The scope of moratorium under section 101 is wider than section 14 of the Code. In State Bank of India v. V. Ramakrishnan and Anr.[26], the Hon'ble Supreme Court has held that the protection of moratorium under section 101 is far greater than that of section 14. As per section 101, pending legal proceedings in respect of the 'debt' and not the 'debtor' is stayed. This difference in language between sections 14 and 101 is for a reason. Section 14 refers only to debts due by corporate debtors, who are limited liability companies, and it is clear that in the vast majority of cases, personal guarantees are given by directors who are in management of the companies. The object of the Code is not to allow such guarantors to escape from an independent and co- extensive liability to pay off the entire outstanding debt, which is why section 14 is not applied to them. However, in so far as firms and individuals are concerned, guarantees are given in respect of individual debts by persons who have unlimited liability to pay them. And such guarantors may be complete strangers to the debtor often it could be a personal friend. It is for this reason that the moratorium mentioned in section 101 would cover such persons, as such moratorium is in relation to the debt and not the debtor.

(h) A secured creditor does not have the option to stay outside the resolution plan process in CIRP except by way of exercising dissent to the resolution plan. In insolvency resolution of individuals, the creditor has right to stay outside repayment plan and not participate in the voting process. Although there is no direct substantive provision in the Code that provides option to a secured creditor to stay outside the repayment plan, it can be implied from the scheme of Chapter III (*supra*) that a creditor has the option to forfeit its right to enforce its security interest and receive payment through the repayment plan[27] or decide otherwise. By exercising such option at the time of submitting claim in Form B of the applicable regulations and by deciding not to participate in the meeting, a creditor would be deemed to have exercised the option to stay outside repayment plan and enforce its security interest in accordance with law. It is clearly provided that the security interest held by a creditor cannot be made part of the repayment plan without the creditor's consent.[28] It is, however, not clear if the secured creditor who has decided not to forfeit the security interest can go ahead and enforce the security interest after such option is exercised, in particular during the period moratorium is in force? This will need to be clarified by the courts.

(i) The AA cannot interfere in the commercial wisdom of the CoC in the matter of approval of resolution plan in CIRP. However, in case of insolvency of individuals, the RP may submit the repayment plan to AA with or without consulting the creditors. If he decides to consult the creditors, all creditors shall have the right to participate and vote in the meetings. If the RP is of the view that a meeting of creditors is not required, she shall provide reasons for the same. In individual insolvency, the AA can approve a repayment plan presented by the RP even if it has not been placed for creditors, if the AA is satisfied that a meeting of creditors is not necessary. This would invariably be in cases where the creditors have conveyed their acceptance to the proposal in writing for payment of their debt as proposed in the repayment plan. The AA can also remand a repayment plan approved or rejected by the creditors, for reconsideration.

If the repayment plan is rejected by the AA, the debtor and the creditors are entitled to file an application for bankruptcy of the debtor under Chapter IV of Part III of the Code. Unlike the passing of order for liquidation of a corporate debtor in the event a resolution plan is not approved; the bankruptcy of an individual is not mandatory or automatic if an application for initiation of insolvency resolution process is dismissed or repayment plan is not approved by AA.[29]

(j) While section 12A of the Code allows withdrawal of CIRP proceedings after admission of insolvency application, no similar provision exists in Part III of the Code.

Insolvency of Personal Guarantors to Corporate Debtors Vs. Insolvency of Partnerships and Proprietorships

Undoubtedly, within the individuals, the dynamics, conditions, and factors involved in the insolvency of individuals that have extended personal guarantee(s) to the corporate debtor are different from ordinary individuals. Personal guarantors can be stated to be fully rational and informed economic actors. There is an intimate connection between such individuals and corporate entities to whom they stood guarantee and the behaviour of the two is in many ways consistent with the economic ideals on which corporate insolvency systems are founded. The personal guarantors are thus, as a separate species of individuals, with deep inter-linkages with the corporate debtor to whom they had stood guarantee. Individuals that are personal guarantors to corporate debtors thus require a somewhat different treatment from ordinary individuals due to economic considerations often involving insolvency of corporate debtor of which they are directors, promoters or shareholders, number of creditors involved, guarantees extended to various creditors, the size of assets involved, and other relevant factors.

Like an individual that has extended personal guarantee to corporate debtor, a partnerships or proprietorship (read as MSMEs) carrying out economic activities too forms a different class within the class of individuals, albeit distinct from personal guarantee to corporate debtor and ordinary individuals.

MSMEs operate differently from larger businesses, and accordingly, the challenges and obstacles they face are unique. They lack the sophistication or knowledge to properly address complex processes with limited resources. They often have less capital, a lower market share in their respective markets, a smaller workforce, and fewer resources overall as compared to large enterprises. They have constrained access to credit and acute difficulty weathering macroeconomic and financial shocks. The role of owners, directors, employees, and debt providers may significantly overlap. There may be no clearly established ownership of key commercial assets between the promoters and the MSME since the promoters may have purchased commercial assets with their own money. The promoter may also use personal monies to fund or support the business without necessarily documenting such expenditures as a loan to the business or in any other way.

The above is particularly the case in India where micro sector with 630.52 lakh firms accounts for more than 99% of total estimated number of MSMEs. Small sector with 3.31 lakh and medium sector with 0.05 lakh estimated MSMEs accounted for 0.52% and 0.01% of total estimated MSMEs, respectively.[30] 196.65 lakh was engaged in manufacturing, 0.03 lakh in non-captive electricity generation and transmission, 230.35 lakh in trade and 206.85 lakh in other services. Lenders treat a MSME akin to an individual requiring personal guarantees of promoters and their assets as collaterals to secure loans. As a result, the advantage of a limited liability corporate structure is significantly reduced for MSME promoters. Therefore, while the partnerships and proprietorship too carry out economic activities, their treatment in insolvency has to be different from the corporate persons and debtors, and in many ways, also from the personal guarantors to corporate debtors. However, the substantive provisions relating to insolvency of partnerships and proprietorship are the same as for personal guarantors to corporate debtors. Only the AA is different, it being DRT in the case of partnership and proprietorship.

Challenges in Rescue Approach of MSMEs Partnerships and Proprietorship.

The statutory provisions of the Code applicable to partnerships and proprietorship is likely to offer many challenges in implementation. Unmanageable debt burdens cause a host of problems for debtors. Constant anxiety arising from inability to pay can cause serious emotional and other problems for individuals, including depression and social withdrawal. Individual insolvency directly impacts the social fabric whereas corporate insolvency has a direct bearing on the economy. The desire to relieve individual suffering is more direct and more central in the context of their insolvency. A whole host of social and economic regulatory issues, such as individual counselling, education, social welfare provision, cultural and religious sentiments and family and housing policy are involved in the insolvency of MSMEs, who are nothing but individuals or set of individuals. This crucial difference forms the basis of the approach to be meted out to individuals and corporate entities during their insolvency.

Insolvency relief for MSME, which is an individual in another form, must address the consequences of insolvency through the prism of humanitarian empathy.

Of particular concern is the complexity and length of typical insolvency processes. In India, out of 633.88 estimated number of MSMEs, 324.88 lakh MSMEs (51.25%) are in the rural area and 309 lakh MSMEs (48.75%) are in the urban areas. For proprietary MSMEs as a whole, 20.37% are owned by female. The socially backward groups owned almost 66.27% of MSMEs. Bulk of that was owned by other backward classes (OBCs) (49.72%). The representation of Schedule Caste and Schedule Tribe owners in MSME sector was low at 12.45% and 4.10% respectively. In rural areas, almost 73.67% of MSMEs were owned by socially backward groups, of which 51.59% belonged to the OBCs. In urban areas, almost 58.68% belonged to the socially backward groups, of which 47.80% belonged to the OBCs.[31] Many smaller MSMEs may lack funds to cover the expenses of an insolvency process or fail to generate an expectation for unsecured creditors to receive any returns.[32] In view of their unique attributes and peculiar challenges that make them fundamentally different from large enterprises, insolvency of individuals demands a process that is easily accessible, simpler, and cost-effective. An ill-designed solvency support could entail sizable fiscal costs and economic side effects.

Like any other business model, MSMEs too are prone to failure. In many economies, they are among the largest commercial users of the insolvency system. The pandemic is hitting small and medium enterprises disproportionately hard. The COVID-19 pandemic has increased insolvency risks, especially among small and medium enterprises, which are vastly overrepresented in hard-hit sectors. Without government intervention, even firms that are viable a priori could end up being liquidated particularly in sectors characterized by labour-intensive technologies, threatening both macroeconomic and social stability. According to International Monetary Fund (IMF), the share of small and medium enterprises with negative equity one definition of insolvency may rise by 6 % points in 2020–21, threatening up to 1 in 10 small and medium enterprises jobs, or a number of jobs comparable to the total number of unemployed. This increase is similar to that seen in the five years after the global financial crisis, but it would occur over a much shorter period. In a downside scenario with extended lockdowns and persistently weaker demand, the share of insolvent small and medium enterprises would rise by 8 % points.[33]

Rising insolvency risks among small and medium enterprises could take the centre stage and become a persistent drag on the economic recovery. Insofar as sales remain depressed while costs cannot be cut accordingly, a growing share of small and medium enterprises (and other firms) could accumulate losses and become insolvent, destroying millions of jobs, weakening the recovery, and also strengthening the market power of large firms in advanced economies (Akcigit and others). Liquidity support cannot address insolvency risks. Further, for firms with weak balance sheets, large senior-debt claims held by banks or government agencies could discourage new financing particularly given high uncertainty about many firms' recovery prospects, leading those firms to delay profitable investment opportunities and lay off workers which, in turn, would undermine the broader economic recovery. Governments may need to gradually shift away from liquidity toward solvency support, while also strengthening insolvency procedures.[34]

MSMEs need policy and financial support to stay solvent. The Government of India has adopted a number of measures to provide MSMEs respite from the impact of COVID-19. Solvency support should be complemented by an effective set of insolvency and debt restructuring tools, including dedicated out-of-court restructuring mechanisms, hybrid restructuring, and stronger insolvency procedures including simplified reorganization for smaller firms, to raise the system's capacity. Because liquidations of a priori viable firms may occur even under adequate insolvency procedures, government incentives could be considered to tilt the balance toward restructuring. Having an efficient, expeditious insolvency system in place that rescues MSMEs or swiftly reallocates their productive assets to more efficient activities is paramount.

Simple Legislative Provisions, Even Simpler Rules and Regulations

The statutory provisions in the Code pertaining to individuals other than personal guarantors to a corporate debtor need a comprehensive review and rehash. The report of Bankruptcy Law Reforms Committee does not discuss the rationale for proposing the framework for insolvency of individuals as comprehensively as it does for the insolvency of corporate persons. The Central Government should consider setting up a committee to revisit the provisions to propose a framework customised to meet the needs of MSMEs.

Disassociating stigma from failure[35]

The biggest stumbling block to effective use of insolvency law by MSMEs, like individuals, maybe the stigma associated with it in India. Like in India, this is true with many other Asian countries. Unlike in the US and England, stigma continues to be a crucial factor in insolvency in this part of the world. American citizens are considered profligate in their personal lives as well as their business lives, particularly in comparison to other world citizens.[36] Consumer spending is considered one of the most important indicators of economic health in the US economy. The stigma of personal bankruptcy is gone (while some dispute it).[37] When it comes to stigma, however, business bankruptcy in US is an entirely different matter. There seems to be less stigma associated with a failing business in US than with a personal bankruptcy, probably due to the US notion that some risk is good and necessary to a well-functioning capitalist economy. The Americans consider business failure to be negative but not morally wrong. They rarely throw corporate officers in jail for failing at business. In fact, in some industries, like the high-tech or dot-com industries, going through a business failure actually can be seen as a badge of honour, proof that the entrepreneurs were willing to take the kinds of risks necessary to fuel capitalism.[38] In other industries, US seems to recognize as a society that one-time events can cause business failure, or that sometimes a change in market conditions cannot be predicted and is better softened by Chapter 11 of the US Bankruptcy Code, if the company is at stake. It can be concluded that Americans do not like business failure, but they find it more acceptable than personal bankruptcy. This distinction appears to be shared throughout most of the world. Unlike the rest of the world, however, US also recognizes that personal financial failure can be caused by business failure, and thus provides systems to help both failing businesses and failing individuals.[39] The theory behind a Chapter 11 reorganization case in the US is that a business enterprise is often worth more to a creditor alive than dead. In other words, a business may be able to pay creditors more by continuing to operate its business, paying creditors a distribution over time from its future profits, rather than simply liquidating its assets and paying creditors from the liquidation proceeds. Alternatively, a debtor can sell its business as a going concern while in Chapter 11, leaving enough time to sell property so that a good price can be realized for the business enterprise, and then use the proceeds to pay creditors through what is called a liquidating Chapter 11 plan.

Personal bankruptcy systems in Europe vary significantly. Most have become far more forgiving in the past decade, following the deregulation of consumer credit. Though none are as forgiving as that of US, England, and the other common law systems. On the business side, European governments are already doing all that they can to enact rescue-style reorganization systems, in order to allow more failing businesses to survive in troubled times. EU businesses prefer UK administration. EU even undertook a study to examine stigma and financial failure in the then EU member states, as well as US, to determine how to reduce stigma about financial failure, for the benefit of the overall EU economy.[40]

Of all of the East Asian countries, Japan has borrowed the most from US bankruptcy systems and also has developed the most complex bankruptcy systems. In the past few years, Japanese spending habits, as well as Japanese bankruptcy and insolvency laws, have gradually become more similar to their US counterparts. But western legal notions are unfamiliar to the Japanese mind, heart, and soul. Traditional Japanese culture emphasises the group over the individual, similarity over difference. Thus, the Japanese feel that it is embarrassing and shameful to need to resort to the law.[41] Shame over debt is still prevalent. With more debt in the system, a recessionary economy, and more business failures, debt-related suicides have risen in Japan. The Chinese also consider it a shameful thing to not pay one's debts, a misfortune that would follow one for the rest of her life. Culturally, like the Japanese, the Chinese are taught to value relationships over money and self-promotion. The reason for low bankruptcy rates and lower priority on insolvency law reform till recently, are both cultural and opportunity-driven. Sometimes the law is not helpful. Much of the time, cultural factors make bankruptcy taboo. In China, businesses can continue to hide behind state ownership even if they are not profitable. No one loses face. Where this is unavailable, such as in Japan's capitalist market, then suicide is one way out; for some it is preferable to using the new laws. Japan and other countries with a strong culture of shame must and a way to balance economic goals, such as fuelling the economy through more and more credit, with the serious ramifications of over- indebtedness. In the end, bankruptcy systems must be drafted to meet a country's cultural, as well as economic, needs. Merely transplanting bankruptcy systems from other parts of the world, particularly culturally dissimilar places, is ineffective. The resulting laws are misunderstood, distrusted, and underutilised. As it emerges from discussion in this chapter, India is not different from Japan and China when it comes to social outlook to insolvency.

Indian social outlook towards insolvency has not changed much over many centuries. Traditionally bankrupts have held a negative image in India except in one or two business communities. The rules of failure to pay debt can be traced back to the Indian scriptures although there was no formal concept of insolvency. Dying without payment of debt was considered dishonourable for the entire family. Ancient Hindu scriptures imposed, liability on the son to pay father's debts. The scriptures made it son's pious obligation to discharge the debts of his father. The obligation of the son was an independent obligation irrespective of the fact whether the son inherited any property from the father. The son was liable to pay to *Vyavaharika* or moral debts. Immoral or *Avyavaharika* debts incurred by father or grandfather were excluded from payment. With the enactment of Hindu Succession Act, 1956 this pious obligation of the son was converted to a legal obligation. The joint family property stands partitioned immediately before the death of the coparcener by the application of this law and the property devolves by succession. The heirs became absolutely liable for all the debts on the share of the property inherited by them. However, if they inherited nothing, they needed to pay nothing to any debtors. Similarly, if the debt was bigger than the value of the estate inherited – the entire estate went go into servicing as much of the debt as possible. But the inheritor had no personal obligation to pay any debt beyond that. Hindu Succession (Amendment) Act, 2005 finally abolished the doctrine of son's pious obligation and now the son cannot be made to discharge the debts of his father solely on the basis of his religious obligation. Now the liability of the children to discharge debts of their father extends only to the extent of the assets inherited by them. The children cannot be made to pay the debts out of their personal assets.

There was no machinery in the indigenous Indian practices providing for the property of a debtor being seized for the benefit of his creditors and divided rateably amongst them. Individual creditors were left to pursue their remedies against the debtor according to rules made by each community for the recovery of debts. The Hindu law, though it has attained considerable perfection in the days especially of the later *Smritis*, contains no indication of anything approaching a system of bankruptcy. There is no trace anywhere of the procedure known to the Roman law as *cession bonorum*. There were rules, however, for the recovery of debts, and they are contained in *Manu Samhita*. It was acceptable –

> that if a creditor makes an allegation against a debtor for the recovery of his money, the king, after the debt has been proved, shall cause such money to be realized from the debtor, and make it over to the creditor. By those means, by which the creditor can realize the amount of claim from the debtor, the king shall cause it to be realized from the debtor and make it over to the creditor. By means of friendly persuasion, by getting its payment assured by a bond or oath,... by arresting the person of his son, or by employing force,... a creditor can realize the money from his debtor. He who will thus realize his money from his debtor, must not be indicted by the king for his having realized the same.[42]

Bankruptcy was common in Mughal India. Apart from the hazards of war and natural calamities that the trader had to face, the bulk of trade in medieval times was highly speculative, for markets, as W.H. Moreland notes, '*were exceedingly narrow; the arrival of even a single ship might convert scarcity into glut.*' An even greater risk was in transporting goods – on land, robbers (and the equally predatory government officials) lay in wait for trade caravans; the seas and rivers were invested with pirates.[43]

Generally speaking, bankruptcy has always been perceived as stigmatic in India except in few communities who considered it as an accepted consequence of an entrepreneurial risk such as in the case of the Agrawal community. The Agarwal's claim descent from the legendary king Agrasena of Agroha. According to the legend, Agroha was a prosperous city and hundred thousand traders lived in the city during its heydays. An insolvent community person as well as an immigrant wishing to settle in the city would be given a rupee and a brick by each inhabitant of the city. Thus, the person would have hundred thousand bricks to build a house and hundred thousand rupees to start a new business. Gradually, the city of Agroha declined and finally gutted in a huge fire. The residents of Agroha, i.e., the Agrawal's, moved out of Agroha and spread to other parts of India. Agrawals fall into four branches: Marwari's, Deswal, Purabiya, and Pachihiye. In modern India, Agrawal families are mostly referred to as 'Marwaris.'[44]

The existing personal bankruptcy laws are a legacy of the British. But Indians have rarely used the laws for nearly a century these laws have been around as many societies sees them as highly stigmatic. In India, insolvency resulted in shame in society for the bankrupt as the perception was, or to a large extent till date is, 'once a bankrupt, always a bankrupt.' The notion of stigma of bankruptcy relates to an idea that the debtor is someone who never intended to repay its financial obligations, committed fraud or chose to ignore its financial obligation. Announcing one's failure, before public can be a deeply embarrassing and stigmatizing one, leading to feelings of guilt, shame, and stigma. Such pre-conceived notions of bankruptcy act as powerful disincentives to debtors in seeking insolvency relief ultimately forcing them to refrain from using it. A bankrupt is disqualified under many laws. Dishonour of cheque for amount paid as legitimate obligation attracts imprisonment even today.[45]

Efforts are needed to educate people so that the society will be forgiving to those who fail. Without legitimatising *bonafide* failure the insolvency law will not serve its purpose. The insolvency law framework should be particularly sensitive to the cultural context of shame and stigma associated with the admission of financial failure. The prevalent notion of shame and stigma thwart the effective participation of debtors in the process and must be resolved by means of public literacy and therefore, a persistent systemic campaign must be launched to educate citizens about the objective of the insolvency and bankruptcy law all over the country to overcome the potential problem of stigma and the citizens should be sensitised and educated through literature and other educational mediums including as part of financial literacy initiatives of the Government and Credit Counselling Centres. Change in social attitude about debt and cultural stigma takes place over time, however, policymakers have time and again made an attempt to minimize the notion of stigma by repealing judgemental language and reducing post insolvency restrictions on activity by debtors. IBBI should commission research papers on the subject and prepare a blue print for addressing the issue of stigma.

Mediation

Part III of the Code includes insolvency procedures that will require navigation through complex legal processes. MSMEs often lack the financial and legal sophistication to deal with complex issues. Non-judicial assistance is crucial and insolvency law for individuals and partnership firms should encourage informal negotiation and resolution to enable the creditors and debtors to bargain in the shadow of insolvency. The majority of insolvency and bankruptcy proceedings involving individuals may not involve contentious issues, voluminous stakeholders, and high amount of debt or disputes justifying adjudication by authorities such as the DRTs. These issues might well be more efficiently resolved with the intervention and assistance of a trained cadre of mediators. Only issues that remain unresolved or legal issues that require adjudication by a quasi-judicial authority could be referred or appealed to such quasi-judicial authority. Mediation assistance may be rendered *pro bono* in certain cases as if, so directed by the AAs.

Vesting DRT with jurisdiction to deal with insolvency and bankruptcy of individuals and partnership firms is likely to hamper efficient access to resolution and bankruptcy, the cost- effectiveness and the desired speed of the process. DRTs are located in state headquarters. Traveling long distance from a village or small town to file or participate in an insolvency proceeding involving small amounts will be time-consuming and rigorous. Moreover, DRTs are already over-burdened with work and suffering from backlog. To add this massive jurisdiction to their existing work will impair the quality of their existing jurisdiction. Therefore, the Code should provide for a time bound mediation process, which recognises debt negotiation and settlement framework. The AA may be empowered to seek assistance from recognised institutions carrying out mediation activities. There are many advantages of this informal system. The debtor may have an incentive to make a higher offer to creditors by avoiding the court procedure, which would benefit the creditors. The debtor may also be able to avoid the stigma of insolvency. The costs of informal settlement negotiations are less than that of a court procedure as it saves both time and resources.

The Code should be amended to provide for time bound mediation in respect of insolvency of individuals and partnership firms as may be prescribed. A new cadre of professional mediators should be recognised to oversee the individual and partnership insolvency resolution process in prescribed cases. Only cases involving above the prescribed debt may be filed directly before the AA. The cadre of mediators should be licenced and regulated by the IBBI. The IBBI may recognise certain mediation centres to provide mediation facility. The Central Government may consider amending the Code to designate the head of district judiciary, by whichever other name called, as the AA in place of DRT. The district judge may designate a judge not below the rank of additional district judge as the AA for the purposes of the Code.

Counselling

Counselling is a critical component of individual bankruptcy. It is essential not only to prevent repeat bankruptcies but also to further rehabilitative goals of behavior modification. There are mainly two kinds of counselling required in insolvency and bankruptcy – debt counselling and social counselling. Debt counselling is based on the assumption that bankruptcy is a consequence of imprudent or unwise use of credit or the need for individuals to adapt their credit behaviour to more desirable norms. Social counselling is part of the welfare state regime. It is usually combined with access to other social services, because debtors may need information about, and referrals to, services such as social security and assistance, low-cost housing, guidance on coping up with the changes in social status, response to behaviour of immediate family, friends and members of community, treatment for substance abuse, marriage counselling, etc.

Counselling is a known practice prevalent in most sophisticated jurisdictions. The US National Bankruptcy Commission in the late 1990s endorsed the introduction of counselling on a voluntary basis. Canada pioneered in 1992 the legislative introduction of two counselling sessions during bankruptcy for individual bankrupts. Singapore also requires counselling in personal insolvency. In Canada, the trustee (or their delegate) must make a pre-bankruptcy assessment outlining options including that of a consumer proposal (repayment of a portion of debt usually over three years); provide an initial counselling session shortly after bankruptcy is declared entitled consumer and credit education; and a second session shortly before discharge which normally takes place nine months after the declaration of bankruptcy. Counselling is financed by a fee, which comes out of the bankruptcy estate. Counselling is a condition for receiving a discharge. In Germany, counselling is considered an important aspect of individual insolvency. Some social banks, notably municipal banks in the Netherlands, provide counselling. In many countries debtors are required to make an effort to reach a voluntary settlement with their creditors before they are allowed to file for formal insolvency relief. A debt counsellor is usually available and obliged to assist the debtor in the negotiations for a voluntary settlement. In some countries, the attempt to reach a voluntary settlement is regulated in a more formal framework, such as a commission for over-indebtedness or the debt enforcement authorities. In others, debtors are left to find counselling and negotiation support from semi-private or private sector actors.

The impact of insolvency on a debtor would be significant, given that there would be a stigma attached to being involved in the process. Counselling should be encouraged for the stakeholders in the insolvency resolution process. For debtors, this would include not only counselling on whether to enter the process, or manage finances and information during the process, but also broader counselling to cope with the potential loss of property and reputational consequences. The IBBI may take the initiative to identify agencies that may be able to provide the required counselling to debtors, and possibly even creditors. Resource constraints may not allow mandatory debt counselling at this stage, but it could be introduced gradually. A cadre of qualified, licensed and trained counsellors be established by making suitable regulations. The cadre of counsellors should be licenced and regulated by the IBBI. They should be bound by the code of conduct to be prescribed by the IBBI. The counselling should be optional or in pre-and post-commencement stages of insolvency and bankruptcy although gradually, once adequate capacity exists, it may be made mandatory in due course. The IBBI should also explore the idea of setting up forums or help desks to assist applicants in filing applications and understanding the insolvency resolution process under the Code.

Financial Literacy

Prevention of insolvency of MSMEs is also critical. The policies should incorporate a desire to attempt to address insolvency by avoiding it altogether through financial literacy training. Financial literacy education is crucial not only for treating existing insolvency, its primary purpose is to prevent its recurrence as well. The Central Government and IBBI should promote financial education in particular about insolvency by collaborating with stakeholders and other institutions operating in the space/ ecosystem.

Insolvency and Bankruptcy Fund

Many individuals and partnership firms may not have adequate and readily available resources, including financial resources to meet even the basic cost of insolvency and bankruptcy and may thus face difficulties in financing access to insolvency. Where the amount of debt that leads to initiation of insolvency is small, it flows from the fact that the debtor is struggling with financial crisis. In such cases, it is the responsibility of the State to support such debtors so that they are not deprived of access to the recourse available under the Code or in effective participation in the insolvency resolution and bankruptcy process. Such assistance and support required in the individual insolvency process is different from legal aid but may have some common elements such as safeguarding the right to access justice. Various approaches to financing exist, such as, state funding of the process, cross-subsidization of low value insolvencies by higher value estates, state subsidies to professionals involved in the process and writing off court costs where there is an inability to repay and no state support beyond any general public good funding of the court system.

The Fund should be utilised to assist debtors and applicants who may not have the capacity to bear the cost for the insolvency and bankruptcy process, and also possibly the remuneration of the RP and bankruptcy trustee in certain cases. Such fund should be recovered as a cost of resolution or bankruptcy, as the case maybe.

Hybrid restructuring (pre-pack) can also contribute to the restructuring of a large number of MSMEs.

A hybrid of out-of-court restructuring and judicial intervention of a formal insolvency procedure can prevent creditors from taking action against the debtor. This is the approach supported by the EU in its 2019 European Restructuring Directive following the experiences of France, Italy, and Spain during the euro area crisis, and the UK in its recent insolvency reform as part of the 2020 Corporate Insolvency and Governance Act. The reduction in judicial intervention saves scarce judicial resources and increases efficiency. Other, less sophisticated examples of hybrid restructuring procedures can be found in common law countries (Australia, Canada, South Africa), that could be improved through targeted legal reforms.

Monitoring Mechanism

Debtors who struggle to budget and distribute proper payments to creditors before an insolvency procedure are likely to struggle afterward as well and thus, confirmation of a repayment plan may not put to end the insolvency proceedings. To facilitate proper implementation of, and debtor compliance with, a plan, a neutral insolvency representative is most commonly appointed to monitor and even collect and distribute payments for creditors. Generally, the insolvency collects periodic payments made by debtors on their own, though some systems require or allow for plan payments to be formally assigned to the representative and automatically deducted from debtors' periodic income to ensure timely payment. The insolvency representative also divides these collected amounts for distribution to individual creditors and is responsible for actually making the payments. After early experiments with more frequent payments to creditors, many systems have settled on annual distributions, both to reduce cost and because more frequent distribution often result in very small payments to creditors. The processing fees for these payments can exceed the amounts transferred to the individual creditors unless larger payments are allowed to accumulate over a longer period.

CONCLUSION

This is not a research paper. It is at best a thought paper aimed at provoking further discussion and advocating a case for further research. An effective framework for insolvency of individuals will help in growth of entrepreneurship. India is one of the fastest growing economies. There is a large segment of MSME entrepreneurs in the Indian financial system who have consistently contributed to the country's vibrant growth-oriented economy since the economic liberalisation in 1991 and starting of the process of laying the foundations of a mature market economy. Entrepreneurship has become increasingly important in sustaining India's rapid growth. The country has an abundant reserve of entrepreneurial talent. An entrepreneur is an individual who proactively seeks to generate value through expansion of economic activity and who creatively responds to challenges and needs encountered in the process of accomplishing this outcome. Risk taking is a critical part of entrepreneurship. A good entrepreneur venture may fail or succeed. The Code was enacted in 2016 as an endeavour to provide one critical building block of the free-market economy which incentivises risk taking, innovation and entrepreneurship. The Code recognises bonafide business failure and offers an opportunity for its revival by way of insolvency resolution process. Similarly, the Code encourages an earned start for the insolvent individuals, where they can restructure their debts or affairs or both on the basis of a repayment plan, and obtain a discharge as per the Code, to resume life afresh. A humanized process can put debtors on a healthier path to supporting themselves, addressing their obligations in a more measured and regular way, and participating in society and economy rather than viewing themselves as victims of it.

1 International Bank for Reconstruction and Development/ the World Bank, Report on the Treatment of MSME Insolvency, 2017.

2 As per the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office, Ministry of Statistics & Programme Implementation during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities (196.65 lakh in Manufacturing, 0.03 lakh in Non-captive Electricity Generation and Transmission1, 230.35 lakh in Trade and 206.85 lakh in Other Services) excluding those MSMEs registered under (a) Sections 2m(i) and 2m(ii) of the Factories Act, 1948, (b) Companies Act, 1956 and (c) construction activities falling under section F of National Industrial Classification (NIC) 2008.

3 Government of India, Ministry of Micro, Small and Medium Enterprises, Annual Report, 2020-21.

4 Ardic O. et al. (2011), "Small and Medium Enterprises: A Cross Country Analysis with a New Data Set", Policy Research Working Paper 5538, World Bank Financial and Private Sector Development Consultative Group to Assist the Poor, Washington, DC.

5 Supra Note 4

6 The validity of the Notification, IRP Rules/ Bankruptcy Rules and IRP Regulations/ Bankruptcy Regulations was challenged by way of multiple writ petitions filed before different High Courts. The Hon'ble Supreme Court transferred the writ petitions to itself. By its judgment dated May 21, 2021 passed in the matter of *Lalit Kumar Jain v. Union of India & Ors.*, 2021 SCC Online SC 396 and other writ petitions and transferred petitions, the Hon'ble Supreme Court upheld the validity of the Notification paving way for the implementation of the provisions of the Code in so far as they relate to personal guarantors to corporate debtors.

7 2021 SCC Online SC 396.

8 Section 96, IBC.

9 Section 99(9), IBC.

10 Section 100, IBC.

11 Section 103, IBC.

12 Regulation 7, IRP Regulations.

13 Section 104, IBC.

14 Section 105, IBC read with regulation 17, IRP Regulations.

15 Section 110(2), IBC.

16 SL. No. 12 of Form B, IRP Regulations.

17 SI. No. 13 of Form B, PG Insolvency Regulations.

[18] Section 110(5), IBC.
[19] Section 107, IBC
[20] Section 108, IBC
[21] Section 112(1), IBC
[22] Section 114(3), IBC
[23] Section 115(2), IBC
[24] Section 103, IBC.
[25] Section 104, IBC
[26] (2018) 17 SCC 394
[27] Section 110 (2), IBC
[28] Section 110(5), IBC
[29] Section 115(2) of the Code.
[30] Supra Note 4
[31] *Ibid*.
[32] Supra Note 2.
[33] Díez, F. et al. (2021), "Insolvency Prospects Among Small-and-Medium-Sized Enterprises: Assessment and Policy Options", SDN 2021/002, Washington DC.
[34] *Ibid*.
[35] Batra S. (2017), Corporate Insolvency, Law and Practice, Eastern Book Company.
[36] Ziegel J. (2001), "The Fragile Middle Class: Americans in Debt, Discussed from a Canadian Perspective", Texas Law Review, Vol.79, Issue 5, pp. 1241, 1244.
[37] Some bankruptcy experts and policymakers believe an increased willingness to declare bankruptcy and a diminishment in the social stigma attached to it are largely responsible for the recent jump in filings. See Neely M. (1998), "Personal Bankruptcy: The New American Pastime, The Regional Economist". This is hardly strong proof that the stigma is gone. See Qualters S. (2002), "Once a Stigma, Ch. 11 Seen as Management Tool", Boston Business Journal, p.1; Maggs G. (1993), "Bankruptcy as a Business Tool, Texas Law Review, Vol.71, pp.681, 684–87;Delaney K. (1992), "Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to Their Advantage" (describing the development of strategic uses for Chapter 11, while reviewing a book whose name speaks for itself); American Financial Services Association, Explaining the Escalation in Personal Bankruptcies, Spotlight on Financial Services.
[38] Forsman T. (2001), "Failure as a Badge of Honor", *Business Week Online*, November 22.
[39] Bi-partisan politics continue to play an important role in the development of bankruptcy laws, though in some respects these politics are counter-intuitive. The credit industry, particularly the consumer credit industry, has pushed tremendously in recent years for stricter bankruptcy laws for consumers that require larger paybacks on old debts. See Warren E. (1999), "The Changing Politics of American Bankruptcy Reform, Osgoode Hall Law Journal, Vol.37, pp. 189, 192–93. These sentiments, though not entirely partisan, are generally thought to be Republican or conservative sentiments; See *ibid*. p.194. Underlying these views is a strong belief that individuals have overspent irresponsibly; *Ibid*. p.195; See Wellman A. (2002), "Relief for the Poorest of All: How the Proposed Bankrutpcy Reform Would Impact Women and Children", Journal of Law & Policy, Vol.6, pp. 273, 274–75. Yet Republican or big-business interests, or even those interested in fuelling the economy, have consistently admonished U.S. citizens to do the right thing and spend even more for the sake of economic growth. This seems inconsistent with the bankruptcy crack-down, given that the government officials who have admonished us to spend, as a group, know full well that most people now have more debt than they can repay and that savings rates are now negative in the United States; See Thurow L., Zeitung B. (1998), "Surprising 1998 American Economic Strength" (reporting negative U.S. savings rates).
[40] Gruner S. (1999), "Seeking a Second Chance: Is Failure Still a Dirty Word?", Wall Street Journal, at A1.
[41] Minami R. (1985), "Comment, Japanese Thought and Western Law: A Tangential View of the Japanese Bengoshi and the Japanese American Attorney", Loyola of Los Angeles International and Comparative Law Journal, Vol.8, pp.301-302.
[42] Jolly's Hindu Law & Custom, chapter 7, para 47-50.
[43] Moreland W.H., India at the death of Akbar.
[44] Harishchandra B., *Agarwalon ki utpatti*.
[45] The Negotiable Instruments Act, 1881.

16

AN ANALYSIS OF INTERIM FINANCE ECOSYSTEM AS A SUPPORTING TOOL FOR THE IBC REGIME

— Vijaykumar V. Iyer, Abhishek Sood and Shashwat Sharma

Executive Summary

Upon commencement of the Corporate Insolvency Resolution Process (CIRP), the Interim Resolution Professional (IRP) or Resolution Professional (RP) takes control of the Corporate Debtor (CD). While taking custody of assets of a CD, the IRP often finds that there are nil or negligible liquid assets available with the CD. To enable the IRP / RP to effectively perform their duties under the Insolvency and Bankruptcy Code, 2016 (IBC / Code), namely, preserve and protect the assets of the CD including its continued business operations, the Code empowers the IRP / RP to seek interim finance to keep the CD as a going concern and smoothly run the CIRP.

The research paper studies the current ecosystem of interim finance under the IBC regime as a support system for IRP / RPs. The authors performed an analysis of the data available with respect to the interim finance raised during the CIRP by the IRPs and RPs; held discussions with the stakeholders involved in order to obtain practical insights and observations; and inquired with a few foreign insolvency regimes, to explore the opportunities for the possible scope of improvements in the current ecosystem. The research paper also identifies the structural and practical challenges being faced by the IRPs / RPs in raising interim finance.

In conclusion, the authors present potential solutions for further consideration, including enabling lenders to extend interim finance, roll-up financing, the introduction of a platform for providing interim finance backed by the Information Utility, change in the working of the committee of creditors (CoC), etc. which could act as a catalyst, thereby supporting the IBC regime in bringing in greater value maximisation.

Keywords: Interim Finance, Differing Views Between RPs and Lenders, Information Utility, Working of CoC, Value Maximisation.

INTRODUCTION

The Government of India had introduced a variety of recovery mechanisms for financial institutions to recover monies owed by entities and individuals to them. Such mechanisms included the Sick Industrial Companies (Special Provisions) Act,1985 (SICA), the Presidency Towns Insolvency Act, 1909; the Provincial Insolvency Act, 1920; the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act); and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). However, most of these mechanisms were not entirely successful for a wide variety of reasons.

Despite the various routes for recovery of bad loans, India continued to face rising non-performing assets in the banking system. Further, to facilitate entrepreneurship, it was felt that a mechanism was required to facilitate entrepreneurs to revive businesses under stress or exit the same expeditiously. Considering the same, the need for appropriate mechanisms for insolvency resolution and liquidation was observed in the country. In 2016, the Code was introduced and implemented and provided a substitute to the already existing mechanisms.

The preamble of the Code clearly states its intent:

> An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders...

The outcome, although still unfolding, has been quite eventful. The Code over time has developed as a catalyst for creditors to resolve stress in the borrowers and recover their debt. The threat of losing the management to a third person IRP appointed by National Company Law Tribunal (NCLT) and the successful resolution applicant has sent strong signals to promoters of stressed corporates. In the words of Justice Nariman,[1] '*The Defaulters' paradise is lost. In its place, the economy's rightful position has been regained*.' The ripple effect of the Code has led to a change in the credit culture of the country and many promoters have tried to initiate repayment of their existing debt[2] through existing mechanisms such as restructuring and settlement.

For companies that do enter CIRP, the RP is tasked with maintaining the going concern nature of the CD, protecting the value of assets and running a time-bound resolution process. One of the key requirements for as RP to perform his duties is availability of adequate funds for such tasks. The Code provides the RP with the authority and power to seek interim financing in cases wherein there is not enough cash flow to undertake activities that would ensure compliance with the Code and a successful resolution.

Such provisions regarding interim financing have been incorporated into the Code on the recommendation of the Bankruptcy Legislative Reforms Committee (BLRC). It is pertinent to note that the interim report of the BLRC discussed rescue financing and super-priority lending in detail and gave a comparison of the existing practices in the UK and the US. Rightly foreseeing the potential challenges in raising interim finance, the Code, following the norms in other insolvency regimes, provides super-priority to funds provided as interim finance and considers such funds as part of the insolvency resolution process costs.

In this paper, we attempt at analysing the interim finance ecosystem and whether the same is able to support the objectives of the Code.

WHAT IS INTERIM FINANCE?

The Code defines interim finance as-

Section 5. Definitions. –

(15) “interim finance” means any financial debt raised by the resolution professional during the insolvency resolution process period [3][or by the corporate debtor during the prepackaged insolvency resolution process period, as the case may be] [4][and such other debt as may be notified];

Further, the Code also provides that any amount of any interim finance raised, and the costs associated with raising such finance will become part of the insolvency resolution process costs, which in turn is paid in priority under the waterfall mechanism as enshrined in the Code. It is pertinent to note that the definition and other sections or regulations do not per se limit the scope of raising interim finance.

Section 5. Definitions. –

(13) “insolvency resolution process costs” means –

(a) the amount of any interim finance and the costs incurred in raising such finance;

Section 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;..

Duty of IRP/ RP

Upon commencement of the CIRP, the IRP / RP takes control of the CD. While taking custody of the assets of a CD, given that the CD is under stress and unable to meet its obligations, it is a common occurrence for the CD to have Nil or negligible liquid assets available. To enable the IRP / RP to effectively perform their duties under the Code, namely, preserve and protect the assets of the CD, including the continued business operations of the CD, the Code empowers the IRP / RP to seek interim finance to keep the CD as a going concern and smoothly run the CIRP.

As per section 25(2) (c) of the Code, it is one of the duties of the RP to raise interim finance. Further, as per section 28 of the Code, the RP is required to take the approval of the CoC while raising such interim finance.

Section 25. Duties of resolution professional. –

(1) It shall be the duty of the resolution professional to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor.

(2) For the purposes of subsection (1), the resolution professional shall undertake the following actions, namely: -

(a) take immediate custody and control of all the assets of the corporate debtor, including the business records of the corporate debtor;

(b) represent and act on behalf of the corporate debtor with third parties, exercise rights for the benefit of the corporate debtor in judicial, quasi-judicial or arbitration proceedings;

(c) raise interim finances subject to the approval of the committee of creditors under section 28;

Section 28. Approval of committee of creditors for certain actions. -

(15) Notwithstanding anything contained in any other law for the time being in force, the resolution professional, during the corporate insolvency resolution process, shall not take any of the following actions without the prior approval of the committee of creditors namely:-

(a) raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting;

(b) create any security interest over the assets of the corporate debtor; …

Thus, the Code recognises that interim finance may be necessary for the purposes of conducting the CIRP, imposes an explicit duty and directs the RP to raise such interim finance when necessary, and provides a defined procedure for obtaining the same.

Need for interim finance

The usage of interim finance is not restricted to enable compliance with the Code's prescribed corporate insolvency resolution process (public notice, the appointment of valuers, providing legal representation before various forums, etc.). The CD may also need to incur various other costs during the CIRP, such as paying employees or paying vendors providing essential services; paying for the costs incurred to regularly complete compliance under other laws; conducting audits (tax audit, statutory audit, etc.). There could also be other scenarios wherein the Insolvency Professional (IP) is directed by the AA or other courts/tribunals to make a payment to a party (e.g., to the electricity company to enable supply of uninterrupted connection of electricity to the CD). The situation gets grimmer when there is nil or negligible revenue/ cash flow available with the CD and the cash deposits have dried up, and thus the need for interim finance gets critical.

Interim finance can be called a life raft in a storm. It can either keep the CD afloat till one of the rescue vehicles arrives and rescues it (i.e., a successful resolution by a resolution applicant) and/or it can enable the RP to guide the CD to reach calmer waters by providing finance to run its operations and generate needed cash flows.

The analogy used herein fits aptly into the current IBC ecosystem as: -

- In certain scenarios, the CoC is only willing to provide interim finance to the bare minimum i.e., to complete the Code prescribed processes (provide enough money to keep the CD afloat and ensure all the Code compliances are undertaken).

- In other scenarios, the CoC may go further and back the RP to act in a manner that could enable the CD to demonstrate a higher value. Such backing could be in the form of providing interim finance to restart a plant or factory (or increase capacity utilisation) or in the case of a real estate project, it could be completing pending construction and selling a part of the inventory.

RESEARCH METHODOLOGY AND HYPOTHESIS

Research methodology

The authors have undertaken multiple tasks to obtain and analyse the requisite qualitative and quantitative data from varied sources/ stakeholders. To enable a comparative analysis across insolvency regimes, the authors have sought data from their global network of firms and have also reviewed publicly available data from other regimes. In addition, the authors have conducted interviews/ discussions with stakeholders' viz. lenders and other IPs to get a broader understanding of the issues on hand.

Further, the authors had also requested data specifically available with Insolvency and Bankruptcy Board of India (IBBI). The authors would like to express their sincere gratitude to the IBBI for providing the said data. The authors have utilised certain tools to analyse the data, and thereafter respectfully present their findings as mentioned below for due consideration.

Hypothesis

For the research paper, the authors had made the following hypotheses that were tested with the help of data and discussions. To clarify, these hypotheses were not pre-conceived notions of the authors to be rebutted by data and were statements that were commonly (mis)understood in the eco-system and only used with limited application to further the analysis and conversations with stakeholders.

- In India under the current regime, the interim financing is provided for mostly by CoC members belonging to private banks and not the public sector banks. There is hesitation amongst public sector banks in releasing funds even after due approval by the CoC with the requisite majority.

- In many cases, interim finance is structured as an unsecured loan having super-priority with excessive interest rates.

- Even in cases where the resolution gets passed by the requisite majority in the CoC meetings, the CDs are not receiving the whole amount of corpus contribution from all the CoC members.

Research propositions

For this research paper, the authors have conducted a deep dive into the interim finance raised by IRPs/ RP's in various CIRPs to date and analysed the data to provide observations on: -

(a) Avenues successfully explored by RPs to obtain interim finance – whether interim finance is raised from CoC members or other lenders;

(b) Sector-wise comparison of success in raising interim finance during the CIRP by various CDs – to identify sectors in which CDs are more likely to be successful in raising interim finance, and the indicative factors for success;

(c) The inclination of interim finance lenders towards security or higher interest payment; and

(d) Any challenges or difficulties of note being faced by lenders / RPs that could be resolved through enabling regulations or any other market intervention by the IBBI/other regulators.

ANALYSIS

Interim financing in India (Pre - IBC)

It is pertinent to note that there was no mandated concept of interim finance under the erstwhile business rescue mechanisms existing in India, as elucidated earlier. During the pre-IBC era, if there was a cash crunch and the company was unable to raise money from the market on its own strengths, the promoter would put in his personal property as collateral or provide a personal guarantee to obtain funds from the market at high-interest rates. For a company under stress, such high interests were in themselves unserviceable but unavoidable, and often proved to be the final nail in the coffin.

Similarly, in the case of liquidation under the Companies Act, the Official Liquidator does not have the responsibility of running the company as a going concern. His primary objective is to ensure that the assets of the company are sold, and the liabilities are paid off. It is only in the case of liquidation under IBC, that the Liquidator is now charged with an additional duty to try and sell the company as a going concern.

In 2009, the Committee on Financial Sector Reforms submitted its report titled: 'A Hundred Small Steps' (CFSR Report). This report discussed multiple principles/ traits which can be seen in the current IBC regime. The BLRC committee has also referred to the CFRS Report in its report and has incorporated the suggestions provided therein. It is pertinent to note that the CFSR Report had dealt with the issue of interim financing. The same was termed as post-commencement financing. The report also encapsulated various other aspects such as priority, approval of reorganisation plan, working of the process (Debtor-In-Possession or Administrator control).

Interim financing in India (Post - IBC)

When the RP takes control of an ailing CD, it is his first duty to take control of the assets, which include the available funds with the CD. This is done to also ensure that the assets of the CD are not misappropriated/ underreported/ siphoned off/ alienated.

Post taking control, the RP is usually faced with the following two broad scenarios:

(a) Where the company is self-sustaining in the short term i.e., able to meet the monthly expenses through internal accruals being generated from operations, or

(b) Where the company has no liquid assets or very limited liquid assets to help it survive even in the short term.

Dilemma at play

Although the Code intends that the interests of all stakeholders are protected, there may arise situations wherein the RP is faced with a dilemma during the discharge of his duties.

It is now common knowledge that the RP must ensure there is no value erosion of the CD, take steps to protect and preserve the assets of the CD and also endeavour to keep the CD as a going concern. Further, the RP also must take actions for maximisation of the value of the CD and in turn, increase the chances of its revival.

The RP requires funds to undertake each of the above activities, and therefore, in cases where the CD does not have sufficient funds, the RP must undertake steps to raise interim finance to fulfil his obligations under the Code. The first port-of-call for the RP for such funds is the CoC itself.

However, given the non-existence of any explicit provision which compels CoC members to contribute their share of the CIRP costs, it often becomes difficult for the RP to raise any additional funding from the existing lenders. The lenders apply a much higher level of prudence when deciding on any additional funding, and in many cases, may be apprehensive of lending further amounts to an insolvent CD already under CIRP on account of stress, considering the higher risk / uncertainty of recovery.

Problem Statement (case study) – Let us explore a hypothetical example of an RP who is appointed to a cash strapped manufacturing company, which is having a non-operational plant/factory and no alternate sources of revenue. There is a very limited scope of further funding from existing lenders. Given the scenario, should the RP limit his ask from the CoC to corpus contributions for running the CIRP or should the RP extend himself and also seek interim finance from the members of CoC to restart the plant? (Restarting the plant may either increase the value of the CD or put the CD into a deeper hole if the restarting plan fails).

This dilemma may be looked at from two viewpoints: -

(a) Theoretical viewpoints:-

- Should the RP restart a non-operational plant? Should the RP dare to take such commercial / operational decisions?
- Under IBC, what is the scope of 'going concern'? Does the provision[5] enable the RP to run the CD as per his writ?
- Why risk, putting the CD on a track, which may be completely contrary to what prospective resolution applicants (PRAs) may have planned?

(b) Practical viewpoints:-

- Will restarting the plant realistically facilitate / ensure value maximisation?
- Can the RP instil confidence in lenders / PRAs / other stakeholders in the CD that it is slowly and steadily getting back on its feet?
- How far can the RP expand the scope of interim finance as allowed under the Code, to justify such expenses?
- Can RP seek interim finance for funding non-essential functions?

There are evidently no straightforward answers to these questions. However, over the course of this research paper and basis our discussions with RPs and lenders, the authors would try to explore possible solutions to these challenges.

Stage wise process

While the Code enshrines the concept of raising interim finance from various stakeholders during the CIRP, it does not provide a detailed framework regarding the process of raising such finance. The stakeholders have, through market practice, developed a practical approach to raising interim finance. To provide a bird's eye view of the process of raising interim finance that is more commonly followed currently, the step-by-step approach has been summarised below:-

(a) IRP / RP estimates the requisite amount

The RP is seen to be the one primarily tasked to take the initiative and decide whether to seek only corpus contributions from the CoC to run the CIRP or attempt to also raise interim finance to restart / extend operations of the CD. For raising any interim finance during a CIRP, the RP prepares a detailed working of the amount required for running the insolvency resolution process, critical operational funds required to be funded and the tentative utilisation of such amount.

(b) IRP / RP presents and defends his working in the CoC meetings

The said working is tabled before the CoC for discussion, consideration and approval by them. Most often, the CoC members tend to raise questions on the genuineness of the amount of demand for funding and the urgency of such funding. Post discussion, the CoC decides on whether financing is to be raised from third parties in the market or provide the required amount itself by creating a corpus for a specific purpose. Negotiations are undertaken to finalise the terms (security, interest rate, etc.)

(c) The resolution is voted upon & passed to obtain interim finance from a third party or creation of corpus

The approval of the resolution is an important checkpoint in obtaining interim finance. The resolution is required to be passed by the CoC, by a majority of at least 66% of the voting shares.

(d) The amount is transferred to a specified bank account

Upon approval of the resolution, the RP seeks payment from the interim financier. In certain situations, the financiers seek that a separate account is created wherein the right to control is with the financier. Further, when corpus contribution has been sought from the CoC members, but certain members hesitate in providing their portion of the financing even after all requisite approvals are in place, the RP generally requests for contribution through multiple reminders and having meetings with such lenders. However, when all these measures fail, the RP is compelled to file an application with the AA for directions to such lenders to clear their payment.

(e) Funds get utilised for specific purposes

To ensure that funds get utilised for the specific purposes for which they were raised, various mechanisms have been developed through market practice. For example, many lenders demand that the contribution, be deposited in a trust and retention account only. Additionally, at times, lenders have required an end-use certificate from the RP.

Who can provide Interim financing?

Interim finance (corpus contribution) from CoC members

During the nascent stages of the IBC, there was seen to be relatively less scope of roping in a third party to provide interim financing (even when the same was provided with a designation of CIRP Cost, which is to be paid in priority). Hence the option generally available to the IRP / RP was to go to the existing set of lenders (CoC members).

In the current situation, the most popular way of raising interim finance is via CoC members, as the definition of interim financing does not provide any restriction on who can or cannot provide such financing. If the funding is limited to corpus contributions to run the CIRP, then generally the CoC members pay the amount in line with their voting percentage in the CoC (if creditors in class are also in the CoC their share is compensated by other members depending on whether the creditors in class have been asked or are willing to contribute). Where interim finance is raised to extend the operations of the CD, it has also been observed that on occasions one of the lead banks provides the funding.

Interim finance (corpus contribution) from homebuyers/ deposit holders

There is a notion that the creditor in class are not willing to pay the corpus contribution, which is why the existing lenders have to pay or reach out to the market. The data, as provided by IBBI, however indicates that some sets of homebuyers/ depositors are willing to fund the CD. Also, in cases wherein there are only homebuyers involved and no financial institution in the CoC, the decision is up to the homebuyers to choose whether to approach external lenders and in turn reduce the payment under resolution plan (as the high-interest rate will be paid in priority and would reduce the amount available for the CD/creditors) or put in the money themselves and receive an interest which is generally higher than the rate of return in cases of fixed deposits. This situation can be termed as 'desperate times requires desperate measures', 'sending good money behind bad money' or an 'investment opportunity' – depending upon the risk appetite and perspective of the creditors.

Discussions with stakeholders voiced that in cases where the proposed interim finance / corpus fund is accompanied by a detailed end-use plan, and such plan results in delivery of flats to homebuyers, the homebuyers are more amenable to considering the funding proposal and pay-in the unpaid amounts against such home-units. However, in such cases strict control over the utilisation of funds is expected and the RP is responsible for ensuring the funds are utilised as proposed and home-units are delivered as committed. There have also been cases wherein the homebuyers have contributed interim finance for the purpose of meeting regular CIRP expenses incurred by the CD, with the primary motivation of earning relatively higher returns (as compared to fixed deposits and other such modes of investment) with the umbrella of protection / prioritisation provided by the Code.

Without being prejudicial to what is stated above, there was hesitation voiced by RPs and lenders to approach homebuyers or deposit holders for interim financing–

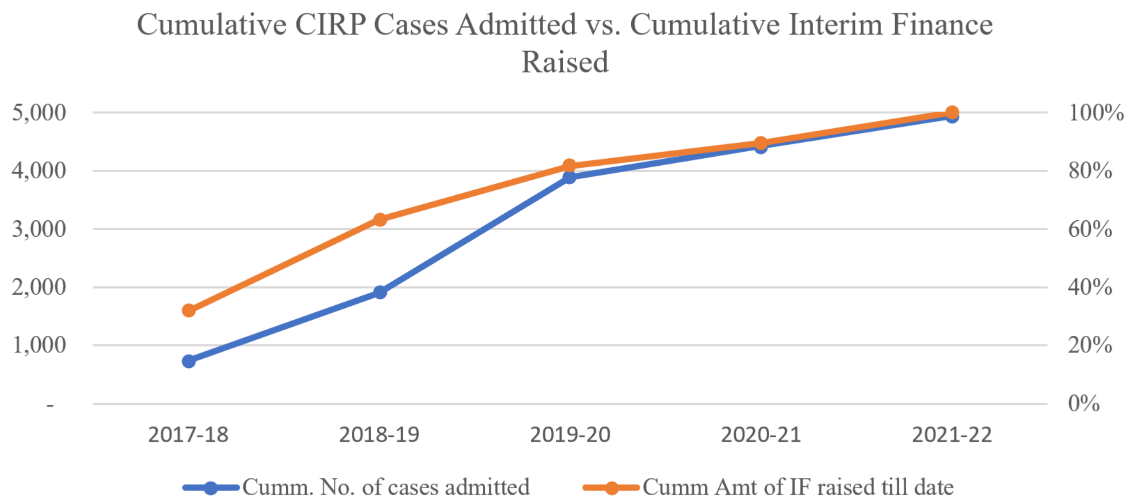
- The risk appetite of such individual homebuyer, or deposit holders is very difficult to assess – individually and/or collectively,

- What policy to take a) making contribution compulsory and compelling uninterested people to pay or b) following a first come first serve basis, being blamed for biases in selection and treatment and missing out on the required target.

- The complication it brings in if there are multiple classes of home buyers or deposit holders.

Interim finance from third parties

The Code allows the IRP / RP to procure interim financing from third parties to ensure that the CD continues as a going concern and it has enough resources to protect and preserve the assets. During the tenure of IRP, there is no CoC but the need for financing is still there. Hence, the IRP can obtain funds from either the applicant, or other outside sources to ensure completing certain tasks such as publishing public notice, etc. However, upon constitution of CoC, the RP is required to take the approval of CoC members for raising interim finance. The process to take interim finance can be an uphill climb.



From the above chart, it can be seen that during the initial years (FY 17-18 to FY 18-19), the growth rate of interim finance was higher than the growth in new CIRP cases being admitted. This was due to increased awareness amongst stakeholders on the benefits of using interim finance in the CIRP. However, from FY 18-19 to FY 19-20, there is a drop in the growth rate of interim finance *vis-à-vis* the new CIRP cases being admitted. Basis the authors' discussions with various stakeholders, this was due to challenges being faced in raising interim finance, enumerated in the latter part of the research paper. Post FY 21, the growth rates of both interim finance and new CIRP cases being admitted, have stabilised, thereby indicating increased confidence amongst the lenders, on the effectiveness of the Code.

Initially, when the Code was introduced, there weren't many lenders willing to risk their funds by providing interim finance. Lenders during discussions indicated that the ecosystem was not perceived to be conducive enough and there were questions on the success of the law. With the Code maturing, so is the ecosystem supporting the implementation of the Code. Today, there are other options available for the IRP /RP to obtain interim financing. Some options are being provided by the Government such as SWAMIH and some are arising with increasing entrepreneurship in the country (entrepreneurs such as LegalPay have started to come forward to provide interim finance on commercial terms to CDs).

Brief about LegalPay

LegalPay provides an opportunity for regular retail investors to play a pivotal role in the distress funding business, by allowing them to invest through specially curated short term, secured, asset-backed lending products. It creates a pool of funds from multiple investors and uses these funds to lend as interim financing, to companies undergoing insolvency proceedings.

Basis the understanding received upon discussions with RPs and other stakeholders involved, it is understood that LegalPay usually charges interest in the range of 20-25% per annum, with the additional condition of the amount being secured against the assets of the CD. However, the exact lending terms may vary on a case-to-case basis.

GLOBAL REGIMES

There have been few reference points for legislators to prepare or amend their insolvency/bankruptcy/reorganisation laws. For example: United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law, European Bank for Reconstruction and Development (EBRD) Core Principles of an Effective Insolvency System and Instrument of European Law Institute – Rescue of Business in Insolvency Law, these reference points provide light on insolvency legislation. There have also been certain insolvency regimes, which, with the backing of their experience and also a certain degree of hit and trial, have been able to come up with workable solutions for common problems.

The terminology used for interim finance varies across jurisdictions. Some of the terms commonly used are debtor in possession financing, post commencement financing, rescue financing, corporate rescue funding, bridge financing etc. Irrespective of the terminology, the ultimate objective of such financing is to provide the corporation with a fighting chance to survive and restart the operations, while simultaneously providing an opportunity to the financier to gain some additional benefits (super-priority under the waterfall, roll up option, the opportunity of a higher rate of return etc.).

UNCITRAL Legislative Guide on Insolvency Law (2004)

The scope of the Legislative Guide has been stated to

> … assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations…[6]
>
> It is to be noted that various jurisdictions have adopted the mechanism provided in the Legislative Guide to amend and strengthen their Insolvency laws. The Legislative Guide also provides guidance on post commencement financing[7] for corporates undergoing the Insolvency Process.

The Legislative Guide touches on various aspects which need to be taken into consideration before making legislation. A few examples include providing a priority to new finance; allowing the creation of security interest in these cases; and providing for situations wherein the existing lenders are against the creation of further security on the already encumbered assets.

EBRD Core Principles of an Effective Insolvency System

The EBRD principles seek to promote the principles of integrity, fairness, and efficiency of the insolvency law. The said principles were first published in June 2007 and were revised in 2021.[8] Currently, there are 15 core principles that are suggested to be actively considered and incorporated in any insolvency regime. Principle no. 11 deals with interim finance:[9]

> An effective insolvency system should, where possible, facilitate the continuation of the debtor's day-to-day operations during a reorganisation procedure by protecting new financing and limiting termination of contracts by contractual counterparties.

Instrument of European Law Institute – Rescue of Business in Insolvency Law

The European Law Institute has provided the following recommendation in their publication[10]

> Member States should ensure that the administrator of the estate (insolvency practitioner or debtor in possession) has the right to take out interim finance based on its own discretion to the extend it is obtained in order to continue a business as usual and, by doing so, to preserve the going concern value of the debtor's estate. The performance of this right should be disciplined by a personal liability in case of the later incapacity of the estate to repay. Only where such a borrowing decision would result in a significant administrative expense, a court or, preferably, a creditors' committee approval should be mandatory.

United States

Being one of the oldest insolvency regimes in the world, the insolvency ecosystem of the US is more evolved. Due to the social advantages of bankruptcy proceedings being acceptable, there is a marked difference between the functioning of the bankruptcy laws of the US *vis-à-vis* the laws of the other jurisdictions. In the US, a Chapter 11 application (filed by the corporations seeking protection from lenders and parallelly maintaining control of the corporation) is a way in which a corporation can undergo reorganisation proceedings. Generally, corporations file an application for debtor-in-possession financing (DIP financing) on the same day as the date of filing of the main Chapter 11 application. Application for availing DIP financing can also be filed at a later stage depending on the need for such financing. To receive DIP financing, multiple approvals from courts, US trustees, secured/ unsecured lenders etc. are required and this makes the process time-consuming. The principle of DIP financing allows the lender to have a super-priority claim that is paid before the payment to any other creditors.

An additional option of roll up financing is also available, wherein the debt provided by the lender, prior to initiation of the insolvency/ bankruptcy proceedings, can also be construed as a priority debt, if such lender lends the finance under DIP financing. Further, the DIP lenders can ask for certain covenants which would assist them to have close control on how the funds provided by them are being utilised and ensure that the same is not being misappropriated. There can also be clauses that provides for veto authority over a plan of reorganisation/ liquidation.

It is also notable that as per publicly available information, approximately $ 20 billion DIP financing was raised in the year 2020.[11, 12] Although the pandemic slowed the lending post 2020, it is evident that lenders in the US look at DIP financing as a viable business opportunity.

United Kingdom

The UK does not have a formal structure similar to that of the US. But there is an informal mechanism via which super-priority for rescue financing is a possibility. The funds taken as rescue financing is termed as administration expenses, and as per the order of the England and Wales High Court in the matter of *Bibby Trade Finance Ltd v. McKay,*[13] the High Court permitted the administrator's liability to a lender who had advanced funds during administration, to be characterised as a legitimate administration expense (and therefore enjoying super-priority or floating charge security). It is pertinent to note that administrative expenses can be payable only out of the company's unsecured assets and, to the extent these are insufficient, those subject to a floating charge. Assets subject to fixed security interests are not, to the extent of the security interest, available for discharging expenses. The result of this is that one can't grant 'super priority' above the holders of fixed security interests, and these secured creditors may have fixed security over much of the company's assets.

Australia

In Australia, an Administrator has the powers to borrow on behalf of the company but there is a personal liability casted upon the administrator for the full repayment along with interest and cost of borrowing. This leads to hesitation amongst the Administrators to borrow any substantial amount on behalf of the company, without taking proper relief under section 447A of the Corporations Act, 2001 (via which the administrator can limit his personal liability) from the Court.

As per a study conducted by Clayton UTZ (a Law firm based out of Australia) on rescue finance, for applications in which the quantum of funding was publicly disclosed following were the findings:[14]

(a) 12 of the applications related to an advance of funds of AU$5,000,000 or more; and

(b) The median funding amount was AU$5,000,000 (i.e., US$ 3.67 million)

Singapore

In Singapore, there have been recent developments in the legal position on raising interim finance for companies undergoing restructuring. They have now started following debtor-in possession financing (following in the footsteps of the US), Further they have adopted the roll-up option as prevailing in the US bankruptcy laws.

Changes with regards to both roll-ups and cross-collateralisation have given rise to some controversy, as they disrupt general bankruptcy principles of equal treatment among the same class of creditors. However, the lack of legislative prohibition means that secured pre-petition creditors may utilise these mechanisms to 'get ahead of the queue'.[15]

FINDINGS

Data provided by IBBI

The approach followed by the authors was to seek data from the CIRP-6 which is filed by an IRP / RP at the time of raising interim finance. Such data collected by IBBI is what has been filled by the IRPs / RPs. For our proposed analysis, we had sought a wide variety of data ranging from multiple data points, but there remain inherent difficulties in collating and transferring such a huge amount of data. For the purpose of the research, the authors have relied on two data sets made available by IBBI-

(a) Data which is published by IBBI in its quarterly newsletters. The latest available data is till the quarter ended December 2021.[16]

(b) Data that has been received from IBBI, for the purpose of our research paper, contains the details of the interim finance that has been raised by the CD since the introduction of the CIRP-6 (in certain cases, IPs have provided details of interim finance raised by them, prior to the date of introduction of the CIRP forms) which in accordance with regulation 40B of the IBBI (Insolvency Resolution Process for Corporate Persons Regulations 2016 (CIRP Regulations) and the circular, is required to be filed within 7 days of raising of interim finance. The data received by the authors has the following details-

- Name of CD, along with the sector of the CD,
- Name of IRP / RP
- Name of the interim finance provider, along with the date and amount of interim finance raised.

The cross-sectional analysis of the two available sets of data brought out some interesting analysis, which have been discussed herein below:

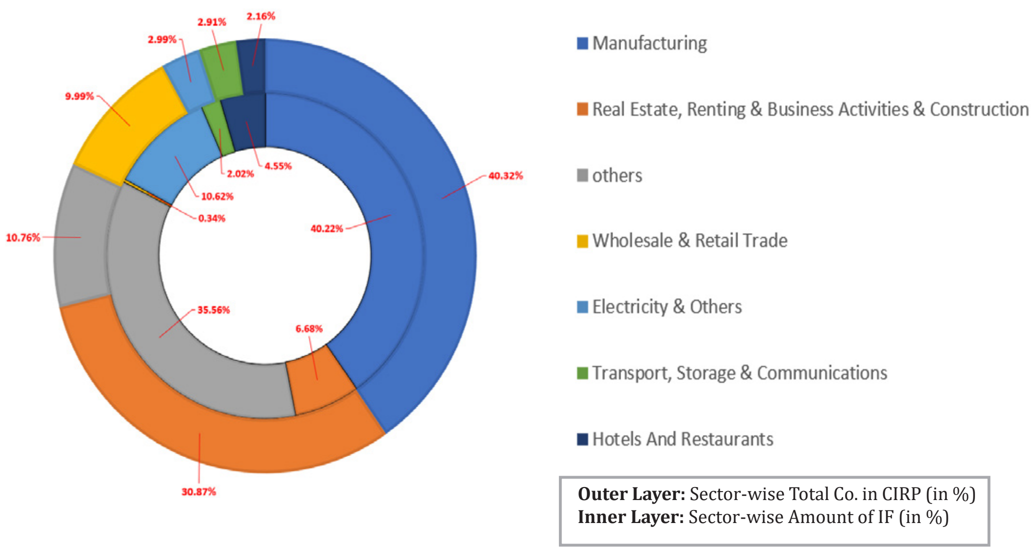


Fig. 1: *Sectoral Analysis of Interim Finance*

Table 1: Sector Specific Analysis

Author's Note: *Table 1 helps us to draw indicative insights into the functioning of the interim finance ecosystem.*

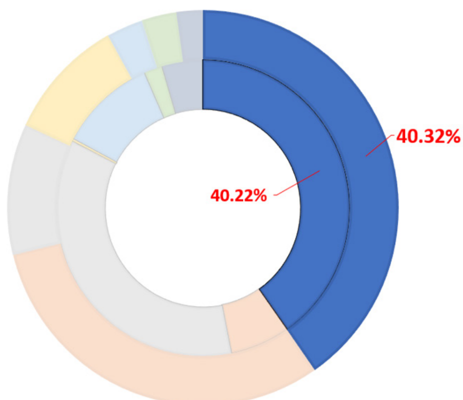
Sector	Total Co. in CIRP (admitted)	Total Co. in CIRP (in %)	No. of Co. raised IF	No. of Co. raised IF (in %)	Amount of IF (in %)
Manufacturing	1994	40.32%	76	40.86%	40.22%
Real Estate, Renting & Business Activities & Construction	1527	30.87%	50	26.88%	6.68%
Others	532	10.76%	21	11.29%	35.56%
Wholesale & Retail Trade	494	9.99%	10	5.38%	0.34%
Electricity & Others	148	2.99%	14	7.53%	10.62%
Transport, Storage & Communications	144	2.91%	9	4.84%	2.02%
Hotels and Restaurants	107	2.16%	6	3.23%	4.55%
Total	4946		186		

The total number of CDs that have been admitted into CIRP as of the quarter ending December 2021, was 4,946. Out of this only 186 CDs i.e., 3.76% of the total cases, have raised interim finance (filed the relevant CIRP-6). Without further data, it has been difficult to specifically identify the reasons for the low number of cases where interim finance has been raised, thus far. The authors continued to research this aspect through discussions with stakeholders.

Limitedly, during the analysis of the data on interim finance, it was noted that in one case, the RP had put in his own money to meet the insolvency resolution process costs. While this may not be possible with large CIRPs, that the RP contributed towards the insolvency resolution process costs, does indicate some level of concern. It is not clear from the data made available, what were the compulsions or motivations that trigged this action by the RP and whether the CoC had approved such contributions made by the RP. Interim finance by the RP leads to a conflict of interest, especially if the financing is provided with interest.

(a) Manufacturing

The analysis of the insolvency cases belonging to the manufacturing sector and the amount of interim finance raised by CDs belonging to this sector shows us that major cases and major money moved toward this sector.

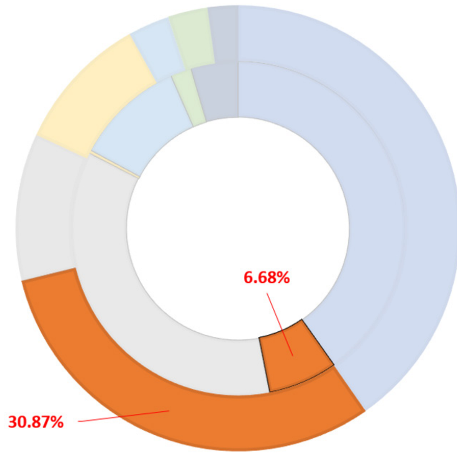


Outer Layer: Total Co. in CIRP (in %)
Inner Layer: Amount of IF (in %)

Fig. 2: *Sector wise analysis of data*

(b) Real Estate and Construction

While 30.87% of the total admitted insolvency cases belonged to the real estate and construction sector, only 6.68% of the total interim finance was raised for this sector.



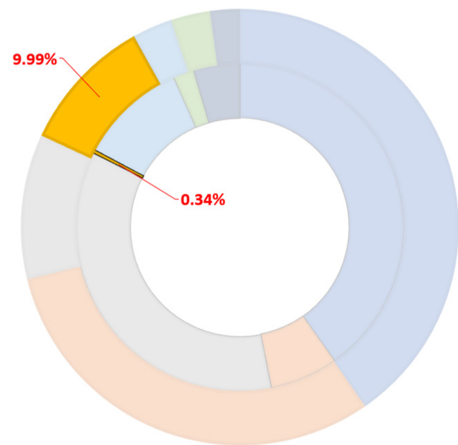
Outer Layer: Total Co. in CIRP (in %)
Inner Layer: Amount of IF (in %)

Discussions with lenders indicated that in cases where the project inventory is mostly sold and majority of consideration is received from the customers, the lenders are not particularly motivated to extend more funds, as the same would be utilised for completion of the remaining construction, which would in turn provide an exit opportunity to the homebuyers, through the delivery of flats – without generating significant receivables. In such cases it is more likely that the home buyers come together to fund the balance construction and take possession of the units.

In projects where significant construction is pending, the RP / IRP takes over a CD with negligible funds, half-constructed structures, with limited possibilities of generating new revenues. In such a scenario, discussions with lenders indicated that the CoC members / external lenders are hesitant to contribute any additional funds, given the high risks and low probability of recovery involved.

(c) Wholesale & Retail Trade

Similarly, of the 9.99% of cases belonging to the wholesale & retail trade sector, only a meagre 0.34% of the total interim finance was raised towards this sector. The data for the wholesale and retail trade sector shows a similar trend to that of the real estate and construction sector.

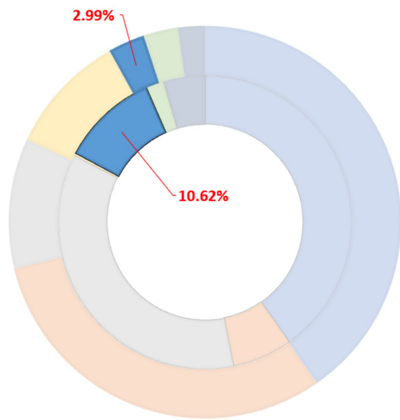


Outer Layer: Total Co. in CIRP (in %)
Inner Layer: Amount of IF (in %)

Discussions with RPs and lenders indicated that when a company belonging to the retail and wholesale trade sector has no operations at the time of the initiation of insolvency, the RP is left with no realisable assets which can be used to generate revenue. The liquid assets like stock disappear (mostly taken over by erstwhile employees, landlords) and the illiquid assets like stores / shops hardly generate any funds for the CD, since many of them are taken on lease. Contrarily, if the company is operational at the time of initiation of insolvency, it indicates a situation whereby the company had potentially positive EBITDA but was not able to service the interest amount on long term debts or the large working capital limits obtained. The applicability of moratorium under the Code gives a breathing space to the CD, during which it does not have to service interest on long term debts. The CD is left with surplus cash flows from its positive EBITDA, which can then be used by the RP to maintain the going concern status of the CD.

(d) Electricity & Others

Of the 148 cases belonging to this sector, 14 cases indicated that interim finance was raised. 'Electricity and Others' is a capital-intensive sector. These companies have a good asset base which have the potential to generate cash flows during the CIRP for routine maintenance to preserve its value.



Outer Layer: Total Co. in CIRP (in %)
Inner Layer: Amount of IF (in %)

It is also to be noted that such projects have long term power purchase agreement (PPA), which cannot be terminated as per the current position of law, on the sole reason of initiation of CIRP[17]. This enables the RP to prevent the erosion of the value of the CD.

For companies which are non-operational and are pending completion of project, lenders and RPs believe that there are limited chances of raising interim financing for completing the project because of the high risk of recovery involved for the lenders; and only necessary CIRP process costs may be funded by the CoC in such cases.

Indicative Analysis

Upon reviewing the said limited data following are the indicative observations-

(a) It was also observed that even though IBBI has provided a standardised format for submission of data regarding interim finance (CIRP-6), there were cases wherein the data had not been correctly provided in the format.

(b) Due to data limitations related to the constitution of CoC, the authors took a sample of the 10 largest interim finance cases and retrieved their CoC list from the IBBI portal / website of the CD. A correlation between the two sets of data indicated that more than 51% of the total interim finance was raised from the CoC members.

(c) Further, in at least three cases the interim finance has been taken from the erstwhile management or the prospective resolution applicant. This indicates that the RP had chosen to explore other avenues for raising interim finance apart from the usual option of the CoC/ external lenders.

(d) It has also been observed that in some cases homebuyers have come forward in providing interim finance. It has also been observed that in some cases deposit holders (directly or via a debenture trustee) have come forward in providing interim finance.

(e) Interim financing is not limited to domestic lenders only; it has also been observed that the interim financing via corpus contribution is also being provided by foreign entities (funds, banks, investment companies) as well.

(f) It has also been observed that in at least three cases, government bodies which operate in the same sector as the CD and are therefore seen as being interested stakeholders, have come forward to provide interim financing to CD undergoing CIRP.

(g) If a bifurcation is carried out on the basis of amount raised by various IRP / RP for CIRP the following is the analysis-

Table 2: Grouping of Interim Finance

Particulars	% of Companies	% of total Interim Finance
Raised Less than ₹ 5 crores	84.95%	12.33%
Raised in between ₹ 5 crores to 10 crores	6.99%	8.04%
Raised more than ₹ 10 crores	8.06%	79.64%
Total	100%	100%

From the above table the following can be noted -

- Around 85 % of the cases (wherein interim finance was raised), amount less than ₹5 Crores was raised as interim finance, this constituted close to 12% of the total interim finance raised. Considering the quantum of the amount, it can be suggested that said funds were likely utilised to cover only the CIRP process cost which are incurred during the CIRP period.
- Further in 7% of the cases the amount raised was more than ₹ 5 crores to 10 crores, this amount may be more than just CIRP process costs and may have also been utilised for activities to preserve the assets of the CD, meeting essential service costs, etc.
- In 8% of the cases, the RP has raised more than ₹ 10 crores, and the total amount cumulates to 80% of the total interim finance raised, this quantum of amount could have been used for capacity development / completion of construction, or for enhancement of value of the CD in addition to meeting process costs.

Data received in other jurisdictions

Upon inquiries with other jurisdictions, it was observed that in foreign jurisdictions, the regulator (if any) doesn't require such level of disclosures of interim finance being raised as in the Indian regime.

Interviews/ questionnaire of stakeholders

To obtain further insights from stakeholders, the authors also undertook discussions with IPs and lenders. Following is a summary of such discussions; the said is provided in Q&A format for ease of understanding:-

Discussion with IPs

Q1. How long does the process take to obtain the interim financing - (from ascertaining the need to receipt of funds from all the lenders)?

Based on our interactions with the practising IPs, we understand that from the time of ascertaining the need for interim financing to the stage of fund disbursement, it usually takes two-three months. Further, in cases involving homebuyers, the process might take longer, sometimes extending upto four-five months.

It was also observed that in cases wherein the CIRP had been ongoing for a longer duration, this time-period generally extended on a proportional manner. The primary reason for the same is that with the passage of time, the lenders become vary about the already blocked capital in an account, which in most cases would have already been classified as a non-performing asset (NPA). It is a general practice for the banks/FIs/NBFCs/ARCs to take multiple internal approvals before processing such interim funding. The process gets prolongated due to the absence of sales projections, debt service coverage ratio, assessment of repayment, etc.

Some of the IPs also mentioned that there had been instances wherein certain members of CoC kept refusing to either acknowledge the need for interim funding as urgent or would not disburse the funds (strategically delay disbursing the funds, so that money comes by way of a trickle) even though CoC approval is in place. In such extreme scenarios, the IRP / RP is left with no other alternative than to approach the NCLT to get a favourable direction under which the CoC members are instructed to pay.

Q2. Are lenders cooperative in providing the necessary funding?

Interim funding was classified into two broad categories:

(a) Funding of CIRP cost – this category is required when the CD is not having adequate cashflows to even meet the basic CIRP cost. In such a scenario, normally the CoC members are requested to contribute to fund the CIRP cost in proportion to their admitted claim, and necessary approvals are taken from CoC in this regard.

(b) Funding of working capital – Interim funding may also be needed for meeting the working capital requirements and to maintain the CD as a going concern. In this situation, it has been observed that CoC members are generally not willing or are not enabled to provide additional funding for an account that is already classified as an NPA and undergoing CIRP.

Further, CoC members are also not that forthcoming about obtaining working capital funding for operational requirements from external lenders. The process of obtaining interim funding from external lenders, would involve an interest rate anywhere between 18-24%. Given the additional financial burden on the CD and creation of priority charge, the external lender's demands on interim funding, the same does not garner CoC approval.

To be successful in having the cooperation of lenders, the following has been indicated as being a preferred approach:

(a) The RP and his team should approach the CIRP with a time-bound plan to operate the CD, and interim finance should be part of the plan from the start.

(b) Immediately on taking over the CD by the RP, an exercise should be initiated to make a case for sustaining operations and the need for interim funding, if any.

(c) The plan should be taken to the CoC immediately on having built a case for interim finance. It is pertinent to mention that a half-baked case/sense of the house should be avoided at all costs as it usually is counterproductive.

(d) If the CoC/key FCs have been convinced basis the above, it usually is a strong ground for approaching interim finance lenders (internal or external).

Q3. What is the market sentiment towards an IP seeking funds for a CD which belongs to an intensive capital industry?

Discussions with IPs have brought out two contradictory views on this specific question:

(a) Some IPs believe that capital intensive industries have a better chance of getting interim finance if there are enough unencumbered fixed assets available with the CD over which a charge can be created. However, this scenario appears to be unlikely given that most capital-intensive industries create a charge on almost all the assets of the company, at the time of obtaining loans from financial lenders.

(b) Many of the IPs seemed to agree on the point that for projects in which the lenders have already burned their hands and made provisioning, there are very low chances of them providing additional funding until or unless there is an official mandate or pressing concerns. Further, if RP has to ensure contribution from all CoC members then he needs to have strong support/backing of key CoC members to encourage the other members of the CoC to also contribute their portion.

Q4. Does the RP actively negotiate with the CoC for reducing the rate of interest? Or whatever CoC decides is final and goes unchallenged?

The RP is expected to negotiate the rate of interest and generally compare it with alternative sources. As stated earlier, in some cases it has been observed that with the increase in the duration of the CIRP, the interest rate charged also increases. This is because of the higher risks involved and the longer time frame for which the capital remains blocked. Practically, given that this is fundamentally a commercial decision, a consensus amongst the members of the CoC determines the terms and conditions of lending, in the absence of any other alternative funding options.

Q5. What all actions can the RP undertake to ensure receipt of funds from unwilling CoC members? Has NCLT order, directing to pay corpus contribution to become a pre-requisite for obtaining funds?

Directions from the NCLT is an extreme step against CoC members who are not willing to contribute even after approvals, and contributions being made by other CoC members. Further, it has been observed that in certain cases, even after the NCLT directive the COC members have not paid their share of the interim finance. In this situation, there is little that the RP can do except for going back to NCLT and registering this as contempt of court and seeking another order. However, this leads to delays in raising the interim finance, additional legal costs which may all be counterproductive. Further, RPs, having to work CoC on many other matters for a successful resolution of the CIRP, hesitate to file such contempt cases against any CoC members.

Q6. Can there be any remedial action that can reduce the hindrances in timely obtaining interim finance for distressed assets (from the regulatory side or incentivising the market)?

There was a consensus amongst the IPs we interviewed that there is a need for remedial action in this regard. The same would have to go through multiple checks to ensure that a clear demarcation is made between the purposes for which interim finance could be raised and purposes for which it could not. This would in turn ensure that there are no blind spots or loopholes which may be exploited.

Q7. Should there be a provision laid down in the CIRP Regulation which would mandate the CoC members to contribute towards CIRP cost [similar to regulation 2A of Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, which mandates contribution towards the liquidation cost]?

A common theme which was accepted by the interviewed RPs was that there was an urgent requirement for the introduction of a provision mandating financing of CIRP cost by CoC members. This would enable the RP to discharge his duties in an effective, efficient, and time-bound manner.

Discussion with Lenders

For the purpose of this research paper, the authors also interviewed few of the bankers in India who have had experience in the IBC ecosystem. From the discussion and deliberations that ensued therewith, such lenders can be categorised into the following two broad categories:

(a) Lenders who are part of the CoC,

(b) Third party lenders (not part of the CoC).

The suggestions and inputs provided by these bankers, touch upon some critical aspects related to the hindrances of raising interim finance and suggestions on how this process could be streamlined. The brief excerpts of the discussions have been summarised below.

(a) Lenders who are part of the CoC

Q1. What are the challenges / issues which are faced by CoC members in sanctioning and disbursing interim financing?

Whenever a company is admitted into CIRP, one of the initial steps for the CoC is to assess whether the company is in a position to be maintained as a going concern. Thereafter, the requirement of interim financing is assessed.

Public sector banks (PSBs) face some additional challenges in providing interim financing. This is because to enable disbursements of such funds, the PSBs have to follow the usual sanctioning process which requires them to justify providing additional funds to an account which has already been classified as an NPA / additional provision has been created on account of CIRP. The solution to this is that banks have started terming such interim financing as 'corpus contribution'. This basically means that the amount that is provided by the bank, is towards its share of the insolvency resolution process costs and is interest free. Thus, banks do not have to necessarily follow the usual sanctioning procedure followed in sanctioning of interim financing. This makes the entire process much simpler and quicker for both the RP and the CoC.

While the Code distinctly gives priority to interim finance (which forms part of the insolvency resolution process costs) over any other payments, both under CIRP and liquidation, there is still some hesitation due to lack of proper documentation. While promoters give personal guarantee / corporate guarantee from other sources, to provide comfort to lenders, the RP is not able to give such assurances and therefore, the lenders have to rely on the resolution plan / security of the CD only. In the absence of such documentation from the RP, the lenders lose out on a sense of security with regards to enforcing their rights for recovery.

Q2. Views around hesitancy amongst CoC members in disbursing the funds post sanctioning.

There are instances wherein the CoC members refuse to pay their share of the corpus contribution, even after the same has been approved through voting. Some of the reasons which cause delays in disbursement even after approval are:

(i) Non-provision of expense invoices / projected cash flows by the RP.

(ii) Psychological aspect – disbursing funds only after other CoC members have provided their share to the RP. This is more relevant in bigger cases where the number of CoC members is comparatively large.

It is suggested that guidelines for disbursal and documentation of interim finance may be created. For example, the Indian Banking Association could provide a standardised template for documentation of the disbursement of interim financing, just the way they have done for the corporate debt restructuring (CDR) mechanism etc. The same could be modified to some extent basis the requirement of different banks.

Q3. Is the creation of additional security for providing interim financing is a deal-breaker or priority as provided under the Code is enough for the comfort of the existing lenders?

Indeed, that it would seem to be advantageous for banks to create a charge / security against any amount disbursed by them. However, the Code provides priority to interim finance, which is superior even to the secured financial creditors. Therefore, the prerequisite of creating security interest, especially when the interim finance provider is part of the CoC, is not compelling.

Q4. How difficult is it to approach homebuyers?

In most of the cases, homebuyers put in their life's savings in buying a home for themselves. Hence, it is unlikely for them to provide further funding, given the hardships they have already faced.

(b) Third party Lenders (not part of the CoC).

The common understanding amongst third party lenders is that till date interim finance has not been considered as an attractive business opportunity. Although there have been some cases wherein external lenders have provided notable amounts as interim finance in CIRP cases, by and large, this market (interim financing) remains untapped.

Q1. What are the challenges / issues which are faced by CoC members in sanctioning and disbursing interim financing?

(a) Procedural Issues – Interim finance may seem like a very good product on paper considering the backing of the statute. However, there are some practical challenges which the lenders face. The same has been enumerated below:

- Reluctance from existing lenders – In cases where the interim financier wants to create a charge over cashflows or other assets and register the same with authorities, existing lenders don't agree to provide a no objection certificate (NOC), which in turn creates roadblocks.

- Credit assessment of the CD and usage of funds – For sanctioning of interim finance there are certain internal procedural requirements such as credit assessment of the CD (whether there have been any cashflows during the CIRP period; is there are interest in the market for submitting resolution plan for the CD; etc.). These internal requirements are often left unanswered by RPs, who justify that the design of the Code provides enough security for the interim finance provider to claim their rights.

(b) Psychological Issues – A prudent RP would probably approach a third-party lender for interim finance only when the existing lenders are not comfortable in providing such funding. This leads to some level of hesitance from an external lender who then ensures that an extended due diligence is carried out before providing any interim finance to the CD. In other words, 'return of capital' becomes more important than 'return on capital'.

Q2. Is the creation of additional security for providing interim financing a deal-breaker or priority under the Code provides enough comfort to the external lenders?

As stated above, even though the Code provides for super-priority to the interim financier, the financier seeks comfort by having a priority charge on the assets or cash flow of the CD, which is something that the existing lenders do not agree with.

Miscellaneous points

(a) The interim financing proposals come at a stage when claims have been admitted but Expression of Interest has not yet been received by the RP.

(b) Interim financiers are hesitant in providing financing to CDs that are not operational or not generating enough cash flows. The intent is to increase the operations and not to restart it (add to the speed rather than restarting something).

(c) A precautionary approach is chosen rather than being perceived to be gambling with the money - Interim financiers would be happy to provide no financing rather than incurring additional cost to enforce their right to recovery before the Hon'ble courts.

(d) Interim financiers are interested in providing the required funding in cases where there is a higher probability of resolution or continuity of going concern rather than liquidation under the Code, considering the delays which might occur due the CD undergoing liquidation.

Table 3: Differing views of the RPs and Lenders

Points of Discussion	RP	Lender
Mandating contribution from lenders towards CIRP costs, similar to regulation 2A of the IBBI Liquidation Process Regulations, 2016 (Liquidation Regulations).	RPs were of the view that there was an urgent requirement for the introduction of a provision mandating financing of CIRP costs by CoC members. There was a common idea that the mandate as put forward in the draft Code of Conduct would genuinely help and enable the RP to discharge his duties in an effective, efficient, and time-bound manner.	Lenders were of the view that there should not be an express provision. It was also stated that on certain occasions the courts have showed restrain in asking lenders to pay up additional funding for cases in CIRP, as it would be unreasonable to force someone to go against their commercial wisdom and put good money behind bad money.
Creation of Security Interest on the Assets of the CD for release of funds (interim finance / corpus contribution)	RPs stated that the security provided in the Code to interim financier is well settled and the same is part of insolvency resolution process cost which is paid in priority regardless the situation (upon implementation of resolution plan or liquidation).	Lenders (third-party lenders) believed that providing interim finance without security interest would be seen to be 'an act of gambling' and not a business activity. The rationale given was that at a later stage of the process there should not be any challenge to the claim of the interim financier and incurring additional costs on litigation should be avoided at all cost.
Delay on disbursement of funds from CoC members	RPs pointed out that there are certain situations wherein all the members don't disburse their part of corpus contribution, even after a resolution regarding the creation of corpus is passed with the requisite majority in the CoC meetings. In these situations, there are very limited options available with the RP to exercise.	The lenders stated that there are internal limitations as the process involved in providing interim finance to an account which has been declared a NPA, the said proposal is required to go through multiple levels of scrutiny to get approval. Further, there is a certain requirement for creating awareness of the importance of timing, need & purpose of such financing.

Possible guidance to address the dilemma

In the section on 'Dilemma at Play', the authors put forward some probable roadblocks, that an RP would generally face, while dealing with the issue of raising interim finance. During the author's discussions with various stakeholders, an extended breadth of responses was received. Broadly, the consensus was that if, in the reasonable opinion of the RP, the actions proposed by the RP are seen to be beneficial for the CD and the various stakeholders in the long run, the said actions should be initiated by the RP with the support of the CoC and pursued.

Every CIRP involves certain situations which cannot be predicted and requires the RP to be on his toes and have the abilities to handle uncertain situations. Further, actions that could have a massive impact on the stakeholders either directly or indirectly, should be thought through and discussed at length with the relevant stakeholders to ensure that all the potential risks are identified and mitigated to the best possible extent.

Every business decision has an inherent risk of failure, and similarly any decision by the RP could either turn into a success or result in a failure. The preferred option for the RP would be to follow a transparent and consultative approach for taking any decision and ensure that the inputs of all the CoC members are taken into consideration. It is also important for the RP that all stakeholders are onboard and on the same page, in order to prevent any challenges to his decisions in the long run.

Initiatives taken by the Government

The Ministry of Corporate Affairs (MCA) vide notification dated March 18, 2020, allowed monies taken from SWAMIH Fund (Fund) to be classified as interim finance under the Code.

The Fund was established under the announcement of the Hon'ble Finance Minister dated November 06, 2019, the Union Cabinet has cleared a proposal to set up a 'Special Window' in the form of alternate investment fund to provide priority debt financing for the completion of stalled housing projects. The sponsor of the Fund is the Secretary, Department of Economic Affairs, Ministry of Finance, Government of India on behalf of the Government of India. The investment manager of the Fund is SBICAP Ventures Ltd, an asset management company that is a wholly owned subsidiary of SBI Capital Markets Ltd, which in turn is a wholly owned subsidiary of the State Bank of India.

As per the website of SBI Capital Ventures Limited, the objective of SWAMIH Fund is as below:

> SWAMIH Investment Fund I has been formed to complete construction of stalled, brownfield, RERA registered residential developments that are in the affordable housing / mid-income category, are networth positive and requires last mile funding to complete construction. It has a target corpus of ₹ 12,500cr with a greenshoe option of ₹ 12,500cr[18]

Therefore, the introduction of the Fund in CIRP cases comes at a later stage of the process. For example- the fund would make initial contact with the RP of the CD (company having a stuck or incomplete real estate project), to ensure that an 'in-principal approval' from SWAMIH Fund is in place. Post this, it will offer the successful resolution applicant an avenue for providing financing at a competitive rate, considering the objective of the Fund is to ensure completion of affordable and middle-income housing projects and not to make profit via interest.

While this provides a much-needed relief to developers operating in the real estate space, the funding cannot be termed as interim finance due to the stage at which it is made available.

It is also to be noted that Reserve Bank of India vide its notification RBI/2021-2022/104 dated October 1, 2021, brought in Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances,[19] the said master circular dealt with the norms which are to be followed by banks in regards to interim financing being given to companies undergoing CIRP, the said had come as a huge relief as it ensured that if no payment is received during the pendency of CIRP the account would not become another NPA.

> **19. Additional Finance**
>
> 19.1 Any additional finance approved under the RP (including any resolution plan approved by the Adjudicating Authority under IBC) may be treated as 'standard asset' during the monitoring period under the approved RP, provided the account demonstrates satisfactory performance (as defined at footnote 16) during the monitoring period. If the restructured asset fails to perform satisfactorily during the monitoring period or does not qualify for upgradation at the end of the monitoring period, the additional finance shall be placed in the same asset classification category as the restructured debt.
>
> 19.2 Similarly, any interim finance [as defined in section 5 (15) of the IBC] extended by the lenders to debtors undergoing insolvency proceedings under IBC may be treated as 'standard asset' during the insolvency resolution process period as defined in the IBC. During this period, asset classification and provisioning for the interim finance shall be governed by the norms laid down in Part A of this Master Circular. Subsequently, upon approval of the resolution plan by the Adjudicating Authority, treatment of such interim finance shall be as per the norms applicable to additional finance, as per Paragraph 19.1 above."
>
> Footnote 16 – 16 Satisfactory performance means that the borrower entity is not in default at any point of time during the period concerned.

Discussion with Stakeholders

During the conference/ discussion with other stakeholders, the following additional points were deliberated–

(a) **Whether the excessive interest rates charged by the Lenders providing interim finance fall within the scope of The Usurious Loans Act, 1918.**

One of the most challenging parts of raising interim finance is agreeing on the interest rate. From the inputs received during the discussions with RPs & lenders, it arose that the interest rate on interim finance varied from 12% to 24%. The reasons highlighted were the market conditions and inherent risk factors for providing funding to entities under CIRP. In some of its orders, the AA too has pondered upon, whether a certain interest rate can be considered as usurious.

AA in the matter of *Spartan Engineering Industries Pvt. Ltd*.[20] held:

> 7. As far as the above contention of the Corporate Debtor that NCLT as an Adjudicating Authority to decide on the applicability of Usurious Loans Act, 1918 to this proceeding is concerned, we are of the firm view that the invoices provide for 24 % interest on delayed payments and the same is not excessive or exorbitant considering the present market conditions. Hence the said request of the Corporate Debtor is rejected.

Basis the above order of the AA, a view may be extended that an interest rate up to 24% would not be excessive or exorbitant for providing interim finance. Further, basis discussions with IPs & lenders, and particularly external lenders (not members of the CoC), the common theme was that interim finance is a risky proposition and even for lenders who are in the business to make money. Therefore, given the overall risk involved for the lenders, external lenders seek an interest rate in the range of 18-24%.

(b) **Using Information Utility as a marketplace for Interim finance.**

Information utility (IU) provides a solution to the issue of information asymmetry. The IU is also providing services such as platform for distressed assets, wherein the RP/ Liquidator can auction the assets of the CD, which is one of the alternate uses of the IU.

Another alternate use for IU would be to provide a marketplace for lenders or RPs to meet for providing and seeking interim finance. A mechanism could be developed wherein the RP floats his requirement for interim finance along with the details of CD and the lenders are able to access such information to further explore and evaluate the proposition. The data available with IU would also assist in necessary due diligence on the part of the lender and reduce the time frame involved.

CONCLUSION

Market experience, supported by our analysis of the data and discussions with various stakeholders including multiple IPs, lenders, and our global counterparts, has shown that the current interim finance ecosystem, despite its challenges, is largely able to support the IBC ecosystem.

The challenges faced by multiple regimes across the globe and the solution to those challenges have helped us develop the current ecosystem in India. It wouldn't be wrong to state that we in India are in a very remarkable position considering only five years have passed by since initiation of the Code and in turn the initiation of the interim finance ecosystem.

There are however several challenges which need to be addressed to improve the facilitation of interim finance: -

Homebuyers do contribute – Require creative solutions

It is a general belief that in the CIRP of real estate companies, it is highly improbable to raise any interim funding from the homebuyers. The reason for the same has already been elaborated in the paper. However, on the analysis of the data provided by IBBI, it was observed that in at least five cases, the RPs were successfully able to raise funding from the homebuyers.

Case Study

The Authors interviewed one of the IPs, who had managed to raise approximately ₹ 1 crore in total from homebuyers, as interim finance. In order to encourage the homebuyers, the RP floated the idea of individual contributions of small amounts from homebuyers who were willing to finance. The CIRP provides a great opportunity to homebuyers to earn much higher rates of return (anywhere in the range of 15-24% per annum; as approved by the CoC) as compared to bank savings / fixed deposits yielding a meagre 2-6% per annum. The token size of such contributions was kept as low as ₹ 20,000/-, to incentivise even the small individual homebuyers to contribute, without the creation of any additional burden on them.

From the above analysis, it is evident that by providing the correct motivation / incentive to the homebuyers, there is possibility of raising funds from them to meet the CIRP costs. IPs need to be creative in their approach while ensuring that the integrity of the process is always maintained.

External lenders

The analysis of the data provided by IBBI shows that there is need to bolster the external lender ecosystem. At present there are limited number of players in the business of providing interim finance to distressed CD, such funding could be either as working capital or last mile funding or funds for capacity enhancement or revenue generating projects. The said is the need of the hour as many lenders who are part of the CoC are unwilling / not supportive of putting in good money behind bad money for rejuvenating the CD. It is paramount to ensure that the roadblocks currently being faced by third party lenders are looked into, viz.

(a) The external lender even though gets natural security from the Code, seeks comfort by having a priority charge on the assets or cash flow of the CD, which is something that the existing lenders do not agree with

(b) The existing lenders are also unwilling to provide NOC, which in turn prevents the external lender to register his charge with authorities.

(c) The existing set of lenders are also unwilling to allow an interest rate of more than 20%, which leaves very less room for external lenders to have any gains from the transaction.

Enabling the Lenders in the CoC to extend interim finance

The suggestions made by IPs and lenders interviewed to enable lenders in the CoC to extend interim finance are:

(a) The development of a practice wherein the end use certification of the funds by a third-party auditor can be provided to the lenders.

(b) The use of the interim finance could also be monitored on a monthly basis by providing period updates through the virtual data room.

(c) The development of a standardised template for documentation of the disbursement of interim financing, just the way it has done for the CDR mechanism (defining the need for any security, not explicitly requiring any personal guarantees (as the RP cannot provide such personal guarantees) and being pragmatic on the extent of representations and warranties required in the documentation). The same could be modified to some extent basis the requirement of different banks.

(d) The IBBI / IPAs could introduce a guide on best practices which would only encapsulate the above practices. The authors have consciously suggested that these practices be incorporated in a document of 'best practices' instead of being introduced as part of the regulations, since codification of micro level activities could cause more harm than good.

Case Study

In the CIRP of a large manufacturing company in India, the RP was able to raise interim funding, the end use of which was to carry out substantial repair and maintenance activities to the plant to enable recommencing and extending operations.

With this, the RP was able to ensure that the production and sales volume both grew at cumulative monthly growth rate of c. 11% over the CIRP period as compared to CAGR of c. -11% and c. -10% for production and sales over a three-year period prior to CIRP. Overall capacity utilisation remained in the range of c. 50% during CIRP, which were carried out from the cash flows of the Company, post approval by the CoC.

Need of change in the working of the CoC

Based on discussions undertaken with lenders, there are few places wherein the need of overhauling the CoC is observed:

(a) Generally, the CoCs tend to work in tandem during the disbursal of the amounts owed (interim finance / corpus contribution) to the CD. It is common phenomenon for the funds to start flowing in from all the CoC members, once a particular CoC member takes the lead to disburse their share of the contribution.

(b) It has also come across as a suggestion to fast-track the process and creating awareness, IBBI, IBA and other regulatory authorities should conduct sessions highlighting the need for and importance of timely disbursal of interim finance in successful resolution of a CD.

(c) Another suggestion which has been highlighted is that if a single CoC member is willing to take the burden of providing the interim finance to the CD, a chance should be provided, and a mechanism should be enshrined in the Code which also provides for certain added benefits to such CoC member. Following is a mechanism which could be put in place:

- If a CoC member 'XYZ' is willing to provide interim finance, the RP may proceed with the approval of 66% of the CoC members (wherein the 'XYZ' should not be considered in such voting).

Advancement in the provisions

(a) The interim finance ecosystem is evolving across the globe, considering the new challenges being faced by various regimes, one of the recent examples would be Singapore, wherein there has been recent changes in the interim finance ecosystem, as they have adopted the US mechanism i.e., DIP financing, they have also tried roll up financing in their regime.

(b) During roll up financing, the previous debt provided by the lender, prior to initiation of the insolvency/ bankruptcy proceedings, can also be construed as a priority debt along with the new funds. The concept has also been explained in section 'United States'. - Such alternatives could be pondered upon and incorporated in the Code to provide the flexibility to the ecosystem to explore and thrive upon.

(c) Considering the recent development coming in the Special Situation Funds,[21] the introduction of the roll up option may also have a positive impact on the interim finance ecosystem and result in increased participation by lenders.

(d) Introduction of a platform for providing interim finance backed by the IU can act as boost for the ecosystem by providing a common marketplace for lenders and RPs to meet.

(e) It is also pertinent to note that actions taken by the IBBI and other regulatory authorities i.e., RBI as discussed in the paper are very much hailed to ensure the improvement in the current standing of the law and ensuring a better future for the ecosystem.

(f) It is also to be noted that IBBI has already taken cognisance of one of the issues talked about in the paper and have introduced Discussion Paper on Code of Conduct for Committee of Creditors dated August 27, 2021.[22] In Annexure to the Draft Code of Conduct following has been provided:

> **2. A member of the committee shall:**
>
> - dd) endeavor to protect the CD as a running business and its assets and take necessary steps to protect the value of the assets of the CD.
> - ee) extend interim finance to the extent required for completion of the process.

It is understood that if the above mentioned two points become part of the Code of Conduct of the CoC, it would be assisting the IRP / RP to discharge his duties more effectively.

FINAL TAKEAWAY

> *'All humans are entrepreneurs not because they should start companies but because the will to create is encoded in human DNA, and creation is the essence of entrepreneurship.'* [23]

Through this research paper, the authors have made a humble attempt to understand the views and the challenges faced by multiple stakeholders who are directly affected within the interim finance ecosystem. Further, the authors have also reviewed and summarised the prevailing practices around interim financing, being followed in various other regimes across the globe. In order to make the research paper data driven, an analysis of the publicly available data along with the data received from IBBI, was undertaken. Through the interactions with the stakeholders, the common pain points were identified and accordingly enumerated in the research paper. This would provide a better picture of the prevailing practices and assist lawmakers to take remedial actions.

It is pertinent to note that in the order passed by the Hon'ble NCLT, New Delhi, Principal Bench dated April 12, 2019, in the matter of *Reliance Commercial Finance Limited v. Noble Resourcing Business And Solutions Pvt. Ltd,*[24] the Bench held that, *'If the non-applicant-respondent fails to contribute, then their claim in the CIR Process would not be considered.'*

While this Order provided for certain extreme measures in situations wherein contributions were not received from CoC members, the prevailing consensus is that a strict implementation of this order may lead to adverse outcomes. In practice, it has been observed that there are existing hurdles which need to be cleared, for smoothening the process of raising interim finance. An effort must be made to incentivise stakeholders involved, to further develop the existing ecosystem around interim financing.

In the present scenario, interim financing under the IBC regime is considered as a tool to enable the IRP / RP in maintaining the status quo of the CD, i.e., to ensure that the CD continues as a 'going concern'. While this approach prevents the CDs from going into liquidation, it is critical to look beyond this limited realm and develop an approach wherein interim finance is looked at, not just as a tool to facilitate the CIRP, but also as an effective means to enhance the value of the CD. To build enterprise value prior to sale, lenders need to think about more than just a holding on operations with the support of interim finance. IPs must develop the competency and thus confidence, to deploy interim financing for the purpose of capacity building of the CD. IPs need to transition from being compliance managers implementing the Code, to be more innovative and become business reconstruction experts who can also effectively turnaround an ailing CD and ensure maximum value is generated for all stakeholders.

It would then be possible for lenders to have confidence in an IP and providing access to funds to undertake the necessary actions to revive the CD. It may also act as a catalyst to make the lenders, partners in the post-acquisition growth story of companies which have undergone resolution under the Code. This would bring in 'value maximisation' in its true sense as has been envisaged by the law makers.

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INTERPLAY BETWEEN MEDIATION AND INSOLVENCY PROCEDURE

— Vinita Singh and Jeeri Sanjana Reddy

Executive Summary

This paper explores the possibility of developing a framework for insolvency mediation in India, using the Draft Mediation Bill, 2021 (DMB). It evaluates the key advantages of insolvency mediation which could improve the existing insolvency procedure. The research paper studies different insolvency mediation regimes across the world to understand the most suitable framework for India. Additionally, the paper delves into giving detailed suggestions for developing an effective framework for insolvency mediation, after exploring the previous attempts to do so. The paper then addresses two key challenges with implementation – the mandatory and binding nature of mediation under the Bill. Based on the observations made throughout the study, the authors confidently suggest the introduction of insolvency mediation in India.

Keywords: Insolvency Mediation, Draft Mediation Bill, Individual Insolvency, Cross-Border Insolvency, Mandatory and Binding Mediation.

OBJECTIVE AND AIM OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The origin of insolvency laws in India goes back to the 19th century English Law. These laws have seen numerous changes over time. With the growing economy and related needs, it had become imperative to bring about reforms in the sphere of insolvency laws. There have been various committees suggesting changes in the insolvency laws that shaped the very insolvency regime in India. There has been a long journey of the development of a specialised insolvency law in India with the Tiwari Committee of 1981 to the Bankruptcy Law Reforms Committee (BLRC) of 2015.

The Insolvency and Bankruptcy Code, 2016 (IBC / Code) came into picture in 2016 as an umbrella legislation for all insolvency and bankruptcy issues of India. It encompasses all companies, partnerships and sole proprietorships. One of the main factors leading to the Code's genesis was the slow, time-consuming insolvency and bankruptcy procedure that existed earlier in India. The preamble of the Code directs for regulation of the laws related to insolvency of corporate bodies in a time efficient manner wherein all the best possible interest of its stakeholders are met. It provides for time bound speedy resolution processes.[1] Prior to IBC, the dissolution of companies was governed by the Companies Act, 1956 and supervised by the courts. There existed an undue delay in the completion of winding up processes because of the inefficient and lengthy systems involved. Following the enactment of the Companies Act, 2013 and the implementation of the IBC, it's the National Company Law Tribunal (NCLT) that looks after the winding up procedure.

IBC has indisputably been effective to a great extent so far. This is evident from India's Ease of Doing Business (EODB) ranking, which rose from 130 in 2016 to 63 in 2020.[2] The index showed a sharp improvement in India's ranking in insolvency resolution, contributing majorly to the overall ease of doing business in the country.[3] However, there exists certain practical ramifications in the implementation of the Code. There has been an increased pendency of IBC cases in recent times. Compliance with the timeline as provided in the Code is a major issue leading to the delay.[4] As per a parliamentary panel report, cases in excess of 71% have remained pending before the tribunals for more than 180 days.[5] One of the major factors contributing to the delay is multiplicity of litigation. The Hon'ble Supreme Court raising concern stated that, '*Judicial delay was one of the major reasons for the failure of the insolvency regime that was in effect prior to the IBC. We cannot let the present insolvency regime meet the same fate.*'[6]

ROLE OF MEDIATION

Commercial Legal Sector

In the last few years, India has witnessed a rapid growth in its economy.[7] With the increase in establishment of different industrial sectors, the related disputes have increased too. Owing to the factors like lengthy procedures and frequent adjournments, India is facing a backlog of pending cases. Currently there are 70,154 matters pending in the Supreme Court alone.[8] The figures are higher in subordinate courts. Although the delay in disposal of cases is not aggregable irrespective of the subject matter, it only becomes more detrimental in cases of disputes of commercial nature. Every single day the commercial entities lose huge amount of money due to delayed hearing of cases against them.

Mediation is an informal proceeding comprising of a neutral third party called 'mediator' who will facilitate the proceedings between the parties. Ascribable to its numerous advantages, mediation has lately garnered a lot of prominence in commercial dispute resolution.

The acknowledgment of reliability and merits of mediation is evident by its statutory and judicial developments over time. It was in the case of *Afcons Infrastructure Ltd v. Cherian Varkey Construction Co (P) Ltd*,[9] where the apex court stated that disputes related to trade, commerce and contract can be resolved via mediation and rightly so. Indian statutes have actively incorporated mediation clause as one of its provisions such as section 442 of the Companies Act, 2013[10] and section 37(1) of the Consumer Protection Act, 2019.[11] A major reliability on mediation was placed in the form of amendments made to the Commercial Courts Act, 2015.[12] The amendment added section 12A that made pre-mediation mandatory. The Commercial Courts (Pre-Institution Mediation and Settlement Rules), 2018 (PIMS) contains the procedure of pre-mediation. However, the rule has made it optional to opt for pre-mediation.

With the statutory developments happening in India, mediation has received a lot of boosts. A significant step that has further promoted the mediation culture in India is the signing of the United Nations Convention on International Settlement Agreements Resulting from Mediation (Singapore Convention).[13] The objective of Singapore Convention is to bring about a global framework governing the enforcement of commercial settlement agreements via mediation.[14] It has been ratified by nine countries and signed by 55.[15] The convention is expected to give a push to mediation in its role of solving cross border commercial disputes. So far, SIMC has witnessed the registration of around 150 cases with the success rate being 70-80 %.[16] SIMC covers diverse sectors including aviation, banking and finance, construction, real estate etc. The signing of SIMC is instrumental in the adoption of mediation as a mode of commercial dispute resolution.

RESEARCH QUESTIONS

(a) Whether mediation is a viable option for the Indian insolvency regime?

(b) Whether the DMB opens new possibilities to introduce mediation framework within the scope of IBC?

(c) Whether trends in insolvency mediation across jurisdictions hold relevance in the Indian context?

RESEARCH METHODOLOGY

The research method is interdisciplinary, between the fields of Law (Role of mediation in the insolvency process across jurisdictions) and Management (Interaction of IBC with other laws, i.e., the DMB). It is primarily doctrinal, with a comparative and analytical approach.

MEDIATION IN THE INSOLVENCY REGIME

Mediation is a widely accepted method of settlement worldwide. It is not generally used in India for insolvency procedure. This is because insolvency disputes have always been resolved through courts. Litigation under the IBC attempts to ensure that creditors' claims are represented fairly (*pari passu*), that the debtor's assets are acquired and equitably distributed, and that the insolvent entity is liquidated quickly. However, in recent decades more insolvency cases are being addressed by alternative dispute resolution (ADR), especially mediation rather than adjudication globally. This can allow a third party to intervene and assist the debtor and its creditors to reach an acceptable deal, avoiding the need for formal insolvency proceedings. There are many advantages of insolvency mediation.

Party-Driven Solutions

To begin with, mediation promotes settlement wherein parties are in 'ultimate control' of the proceedings and terms of settlement.[17] In most countries, the legislators have opted for either a pro-debtor or a pro-creditor insolvency regime. In India, the case of *M/s. Innoventive Industries Ltd v. ICICI Bank,*[18] depicts a transition from a pro-debtor to a pro-creditor scenario. This winner-takes-all scenario, however, does not have to be the only option. Mediation increases the chances of a situation in which both sides can satisfy their essential claims by reducing their requirements to some extent.[19] Rather than reaching a final/binding resolution, insolvency mediation encourages the settlement of the conflict. It's flexible and encourages 'party-driven solutions' by allowing the parties to find common ground through persuasion.[20]

Preservation of Business Relationships

Mediation can provide a platform for healthy negotiation between the parties involved. It is crucial for resolution of conflicts where the parties don't want to spoil the ties amongst themselves. It's important in business to maintain amicable and profitable ties with other entities in the market that you work with. Taking any dispute matter directly to the court ruins the working relationship. Because mediation focuses on cooperation, it can aid in the preservation of business relationships which isn't possible in litigation. Even if a mediation does not result in a settlement, it can help the creditors and debtors communicate and negotiate better.

Levelling Differences Between Stakeholders

When a case of insolvency (bankruptcy) is filed, the debtor is usually winded up which causes the irreconcilable common pool problem. Operational creditors such as employees and suppliers of the entity often find themselves unable to find a platform to raise their concerns. They don't get a representation in the committee of creditors (CoC), which is the principal body involved in the decision-making of a corporate insolvency resolution process (CIRP).

The Code provides varying treatment for different class of creditors. Section 21(2) of the IBC,[21] which deals with the composition of the CoC, says that the CoC must include all of the financial creditors (FCs) of the corporate debtor (CD), excluding the participation of operational creditors. It's worth noting that the IBC doesn't specify a minimum number of FCs needed to form a CoC. This means that even the presence of a single FC is enough for the insolvency resolution process to be completed, as was the case in *Café D Lake Private Limited*.[22] Furthermore, the voting share is the proportional share of the financial debt owed to FCs. Therefore, operational creditors are only allowed to attend a CoC meeting if their debt is equal to or greater than 10% of the CD's total debt,[23] or in the absence of an FC - as provided by regulation 16 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations.)[24]

Therefore, there are chances that concerns of operational creditors may not get addressed appropriately. Such conditional representation of operational creditors contradicts the IBC's stated goal of 'balancing the interests of all stakeholders'.[25] To meet this objective, operational creditors should be given a participation in decision process to guarantee that their interests are properly addressed. It is here that the introduction of mediation can resolve this issue. Insolvency mediation aims to level these differences by giving a chance to all the parties to put forth their concerns and try and reach a middle ground.

Efficient Use of Time

Insolvency mediation can drastically minimise the time required for both parties to obtain a resolution, and it is a welcome alternative to the time-consuming, lengthy, and expensive litigation procedure. One of the major reasons for delay in litigation-based resolution is the involvement of unhappy stakeholders. Challenges and interim applications especially by operational creditors have led to many cases being dragged out. There being no stipulated timeline for operational creditors to challenge the rejection of their claim, permissibility of intervention by promoters at the admission stage as well as long gaps between conclusion of hearing and passing of written orders are all causes of delays in the existing process.[26] Since insolvency mediation aids in levelling differences and party autonomy, such judicial delays due to unhappy stakeholders can be avoided. Additionally, some delays are caused by shortage of judges.[27] However, if some cases are resolved through mediation instead of CIRP, insolvency mediation can go a long way in also reducing the workload imposed upon the judicial system.

Cost Effective

Parties to any insolvency proceeding, whether debtors or creditors, are severely hampered by financial difficulties. Litigation and the consequential court procedures will only complicate the situation, with the strain being exacerbated by judicial delays. The longer the insolvency procedure takes, the longer the debtor hangs in limbo, with the value of its assets depreciating. Mediation proves to be a cost-effective option in this case, by avoiding delays associated with the litigation process. Additionally, the DMB encourages online mediation, making the resolution of insolvency situations through mediation to be more cost – effective than CIRP.

Confidentiality

Any case that goes to court will become publicised. Mediation mechanisms, unlike court proceedings, are better adjusted to safeguarding critical and sensitive corporate secrets and information - a vital incentive in commercial relationships. Moreover, is also practical to consider the embarrassment and guilt that public announcement of failure to run the company involves. Stigma associated with declaring insolvency acts as a major deterrent in the seeking of insolvency relief by debtors. It also effects the active participation in insolvency procedure by debtors as well as creditors. In such instances, confidentiality proves to be a crucial necessity in the insolvency procedure, which can be provided by insolvency mediation.

Mediation therefore permits insolvency cases to sidestep some of the pitfalls associated with litigation (e.g., cost, publicity, and inflexibility).[28] The intricacies of procedural regulations surrounding court procedures, endless delays and obscenely high costs incurred during litigation drives can be avoided, thereby also ensuring that the debtor's assets are not squandered on such expenses.[29]

ADR AND INSOLVENCY ACROSS JURISDICTIONS: LESSONS LEARNT

In this context, it would be useful to examine the use of ADR procedures for insolvency matters across the world, especially mediation. Many countries, including the US, the Netherlands, and Singapore, have attempted to implement conflict resolution through mediation in particular. While some jurisdictions treat ADR in insolvency matters to be informal proceedings, others have made them formal. Some countries have even set up a hybrid structure, i.e., ADR with court interference to a certain extent. This paper shall examine ADR, especially mediation in insolvency procedures across jurisdictions.

Singapore

In April 2016 the 'Committee to Strengthen Singapore as an International Centre for Debt Restructuring' released a report that recommended the use of mediation for efficient restructuring.[30] The committee suggested empowerment by statute to employ insolvency mediation through two mechanisms, and encouragement by the judiciary for parties to take recourse to mediation to resolve insolvency. Singapore also announced sweeping improvements to its insolvency and debt restructuring legislation in May 2017.[31] In recent times, Singapore courts have strongly encouraged, but not mandated insolvency mediation.[32]

Centres such as the Singapore Mediation Centre have recognised that engaging alternative forms of dispute resolution is a useful process for all stakeholders such as debtors, FCs and/or insolvency administrators who desire to come to a quick and amicable solution in relation to continuity of the business and/or settlement of debt. Therefore, it has already established Mediation Procedure for the insolvency cases, supplemented by Rules and Fees for the same. However, with insolvency mediation being made voluntary instead of mandatory, the established framework for it remains vastly under-utilised in Singapore.[33]

The United States of America

The idea of insolvency mediation was first established in the US in 1986, and it is still used in the insolvency resolution process today. Debtor restructuring takes precedence over liquidation and restructuring plans are designed in such a way that business and commercial activity can 're-start'. Sub-chapter V of the US Bankruptcy Code[34] was implemented in February 2019 to assist small businesses in effective restructuring. The US routinely uses mediation, it has proven to be quite useful in cases such as the Lehman Brothers'. While some mediations are voluntary, court-ordered mediation is usually mandatory.

Case Study:

In the US, the *Lehman Brothers insolvency*[35] is considered the largest in US history, with a whopping debt of US$768 billion. The investment banking powerhouse, with assets of US$639 billion, was the largest casualty of the Global Financial Crisis, which rattled global financial markets between 2007 and 2008. The 158-year-old Lehman Brothers Holdings filed for bankruptcy in September 2008. The court imposed mandatory mediation for derivative contract issues in September 2009. From around US$9 billion in pending claims, 110 mediations have brought in US$333 million for Lehman Brothers' estate as of 2016.[36] Despite the deficiency, hundreds of unsecured creditors were paid between 20 and 40 cents for every dollar of debt, compared to the typical norm of only a few cents per dollar at the time.

Insolvency mediation was the key. Because the Court permitted Lehman Brothers to go through mediation with its creditors, the firm could collect on payments owed. Unfortunately, even after more than a decade, the fact that Lehman Brothers had successfully mediated through some challenging hardships in insolvency remains hidden, and the approach is still overlooked when settling such claims.[37]

The European Union

Several EU member states have implemented not just insolvency ADR, but also pre-insolvency dispute resolution techniques geared largely at debtor rescue – with not just mediation in particular.

In France, the insolvency procedure employed is largely determined by the debtor's financial status.[38] The choices are pre-insolvency proceedings which are either court-assisted ('*ad hoc* mandate' and 'conciliation') or court-controlled ('preservation'), or insolvency proceedings ('judicial rescue' and 'judicial liquidation'). The French Court of Cassation ('*Cour de cassation*') has highlighted the significance of confidentiality and flexibility in such procedures. It is imperative to note that the law is silent on how parties are to negotiate an amicable agreement. Despite this, 70% of 1,000 conciliation procedures opened in France in 2015 were successful.[39] The Court, if involved, only played a formal role.

The Italian insolvency system provides an array of choices for businesses in financial distress to reorganise their debt, all of which are handled – entirely or partially – extra judicially.[40] The Bankruptcy Law, ('*Legge Fallimentare*') provides three legal vehicles for debtor restructuring, each with its own set of features. The choice of mechanism depends on the type of business as well as the steps required to keep the business afloat. However, without suitable legal framework, these procedures for restructuring without resorting to judicial intervention have a low success rate in Italy.

In Spain, a new chapter regulating an insolvency mediator was added to the Spanish Insolvency Act in 2013. The Second Opportunity Law of 2015[41] made changes to the responsibilities of the mediator. Currently, Spain encourages three forms of out-of-court agreements without judicial intervention.[42] One of these, '*Acuerdo Extrajudicial de Pagos*' is considered to be a valuable solution to help small and medium-sized businesses (SMEs) by the intervention of a '*Mediador concursal*'. In this scenario, the mediator's responsibilities go beyond simply resolving disputes; instead, they include organising and facilitating meetings between parties, drafting resolution plans, and other similar activities critical to the mediation's success.[43]

The United Kingdom

The courts in the UK have unequivocally encouraged the use of mediation in suitable matters. The Chancery Court Guide 2009[44] provides rules whereby insolvency cases are handled before it and includes a chapter (17) on ADR. The chapter puts special emphasis on mediation and urges the parties to consider ADR in all cases. As per the current company and insolvency statutes, Schemes of Arrangements are frequently utilised to settle the claims attached to an insolvent entity. Schemes of Arrangements refer to a court-approved agreement between the entity and its creditors/shareholders. Companies Act 2006-Part 26[45] and Insolvency Act 1986-Part 1[46] provides for schemes of arrangements. Dispute Resolution Procedures are frequently included in the provisions of such Schemes of Arrangements.

PROPOSAL FOR IMPLEMENTATION OF MEDIATION WITHIN THE INSOLVENCY REGIME IN INDIA

Previous Efforts in India

In October 2018, the Insolvency and Bankruptcy Board of India (IBBI), in its 'Report of Working Group on Individual Insolvency India'[47] acknowledged that mediation and counselling would be useful complementary mechanisms to the structure for insolvency in the Code.

The Report duly noted the problems faced by individuals lacking financial and legal means and experience. A number of individuals involved are not even related with business of any sorts. They do not require the addressal of contentious issues, involvement of stakeholders or debt related dispute, requiring adjudication from Debt Recovery Tribunals (DRT). To resolve the issues of these individuals, the Report suggested *'the intervention and assistance of a trained cadre of resolution mediators'*. The Report highlighted the importance of non-judicial assistance in order to encourage the informal negotiation settlements. It holds special importance for insolvency in business carried by individuals through partnership and proprietorship. Unlike litigation, mediation prevents the excessive time and resource consumption. The very insolvency process entails the inclusion of sophisticated legal procedure and related legal and financial documents. Mediation as a tool to resolve issues of insolvency and bankruptcy can eliminate these hassles.

Additionally, the Report highlights the attached issue of stigma regarding insolvency. An informal negotiation for settling issues is crucial to avoid the said stigma especially for individuals running small businesses. Standing as of today, India lacks the experience and expertise of dealing with individual level insolvency and bankruptcy.

However, the Report expressed reservations when it came to implementation, since comprehending a complete framework for mediation is likely to consume considerable time. Therefore, the RWG decided that this may be dealt with in subsequent reports, since *'to have a mediation and counselling procedure in the Code, some further changes in the law would be required'*.[48] The Report suggested carrying out of research on the current condition and structure of the Code to analyse the incorporation of mediation in insolvency processes. It also suggested the study of practices in other countries like the UK, US and Singapore to understand the manner of operation and implementation of mediation and counselling in insolvency and bankruptcy cases. With the inception of the DMB,[49] coming up with a mediation procedure within the insolvency regime cannot be done at a better time. The DMB includes provisions that can be instrumental for the introduction of mediation in the insolvency process.

Parvinder Singh v. Intec Capital Ltd & Anr,[50] is one such case that is reflective of previous efforts to settle insolvency case via mediation and successfully so. In this case, an authorised representative of the promoters appealed against the Adjudicating Authority's admission order. Additionally, the appellants stated their willingness to negotiate and resolve the FCs' claims prior to the creation of the CoC. Both the parties involved agreed for resolution via mediation. The National Company Law Appellate Tribunal (NCLAT / Appellate Tribunal) appointed a retired judge as mediator and ordered to commence the mediation process. In addition, the Tribunal provided for the revival of CIRP in case of any breach of the terms of settlement or default of payment of post-dated cheque. The mediation process took place before the formation of CoC. The parties successfully settled the issue and the report was submitted to the Appellate Tribunal which held the terms of settlement reached as the final order.

THE DRAFT MEDIATION BILL, 2021 AND INSOLVENCY PROCEDURE

Pre–Insolvency Debt Restructuring through Mediation

The Code establishes a two-stage procedure for dealing with insolvency. First, the financial and legal specialist restructures the company's entire working through CIRP. Second, when restructuring of the firm fails, liquidation takes place. Once CIRP is initiated, a CoC is formed. However, due to numerous factors involved,[51] there is significant delay in the completion of CIRP. Therefore, before the initiation of CIRP and formation of the CoC, we believe all stakeholders can enter into fruitful negotiations through mediation.

Pre–Litigation Mediation: Framework

Under the DMB, if a person is involved in a civil or commercial conflict, he or she must first try to resolve it through mediation before resorting to judicial intervention. According to section 6(1), *'A party shall, before filing any suit or proceeding in any Court or Tribunal, take steps to settle the disputes by pre-litigation mediation in accordance with the provisions of the Draft Bill.'*[52] This can be done regardless of the whether or not a Mediation Agreement exists. Moreover, the court or tribunal may refer the parties to mediation at any point during the insolvency proceedings on the request of the parties despite failure of it at the pre-litigation stage.

The Bill bars certain disputes from mandatory pre-litigation mediation under its First Schedule. also makes consequential amendments to certain laws – by either substituting or inserting provisions in them. For example, under the Seventh Schedule, the Bill substitutes section 18 of the Micro, Small and Medium Enterprises Development Act, 2006[53] with a provision for mediation to be conducted by either the Micro and Small Enterprises Facilitation Council or any mediation service provider under the Bill. Under the Eighth Schedule, the Bill substitutes section 442 of the Companies Act, 2013[54] to make a reference to mediation. Under the Ninth Schedule, the Bill substitutes Chapter III A of the Commercial Courts Act, 2015[55] to mandate pre-litigation mediation and settlement. Finally, the Tenth Schedule, the Bill proposes the omission of 'Chapter V: Mediation' of the Consumer Protection Act, 2019.[56] It also omits section 2(25) and section 2(26) which define 'mediation' and 'mediator' respectively. It substitutes section 37 under the 2019 Act with a new mechanism for reference to mediation, and proposes other changes under sections 38, 41, 101, 102 and 103.

Similarly, it is proposed that with the Bill not placing any bar on insolvency mediation under its First Schedule, mediation under the Code[57] can be envisaged as a new Schedule under the DMB, just like it has been envisaged for several other matters under varying laws. In such pre-litigation mediation, we envision the objective to remain the same as is under the IBC: creating a resolution plan that meets the needs of all creditors while allowing the debtor to continue operations (debt-restructuring), failing which settlements of claims for liquidation can be considered. Out of Court debt restructuring is very common in several jurisdictions as discussed in Chapter IV of this paper.

Stipulated Timeline

The IBC was enacted in India with the objective of making the resolution process more efficient. The preamble states the aim of the Code to be '*reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner.'* As per section 12 of the IBC, the CIRP has to be completed within 180 days from the day the application is filed for initiation of insolvency process. Regulation 40 of the CIRP Regulations,[58] provides for an extension of maximum 90 days for the CIRP to be completed. In the case of *M/s. Surendra Trading Company v. M/s. Juggilal Kamlapat Jute Mills Company Limited*,[59] the Supreme Court emphasised on the maximum time limit of 270 days, beyond which extension should not be given. However, the excessive litigation involved in the CIRP process has resulted in frequent delays in the disposal of the insolvency procedure. The adjudicating tribunals, the NCLT and the NCLAT are overburdened with other commercial cases too. To address the issue of exceeding time being taken, two provisos into section 12(3) of the IBC were added and the deadline was revised and extended to 330 days. This 330-day maximum resolution time limit includes litigation and judicial processes.

The very essence of the IBC was timely resolution of cases. Its intended benefit included maximisation of asset valuation, promotion of entrepreneurship, credit availability and balanced interest of all the stakeholders involved. However, due to the judicial delays, this objective is not being met. As on March 2021, as much as 79% of the ongoing 1723 cases were unresolved, breaching the 270-day limit with the average time taken to resolve a case being 459 days.[60] This has caused an increased number of non-performing assets and some major destruction in asset valuation. The frequent delay adversely impacts the commercial assessment done by the parties for any sort of negotiation. The creditors, employees and the company itself suffer because of the inordinate delay. The longer the resolution takes to complete, the more the value of CD takes a dip. The whole CIRP process becomes expensive and inefficient, defeating the very aim of time bound efficient resolution process.

India has the option and experience of alternative dispute resolution for commercial cases. However, these options have not been incorporated in insolvency regime yet. Introduction of mediation in the insolvency procedure can be the remedy to these issues. As per section 20 of the DMB,[61] a period of 90 days is stipulated from the commencement of mediation for its completion. Further, an additional duration of 90 days can be granted as extension with the consent of parties. This will not only promote a more dispute-resolution oriented approach during the insolvency process, but also ensure that it takes place in a timely manner. Mediation not only will save time but will also safeguard the relationship between the company and the various stakeholders involved. Not every dispute has to result in the end of the business relationship between the debtor and creditors. The mechanism of mediation working under the insolvency regime can assist with the post pandemic situation too. It can help mitigate the damage caused by debt overhang especially amongst the individual and small-scale businesses. The 90-day time limit with an extension of additional 90 days is practical enough to accommodate any possible delay that may occur. It gives the parties ample time to sit amicably and negotiate for a viable plan of action. This gives the parties a chance to weigh out their options and try to resolve the dispute outside court saving time for the debtor, creditors and every stakeholder involved.

Who Can Participate In Insolvency Mediation?

As stated earlier, a key advantage of insolvency mediation is levelling such differences and ensuring equal representation of all stakeholders. If mediation takes place only between the CoC and the CD, then such pre-litigation mediation wouldn't be any different from the CIRP, wherein all other claims and extinguished when a Resolution Plan (which sometimes doesn't include the claims of certain creditors) is approved. For instance, if a claim is submitted in the wrong form, it is not considered in the Resolution Plan; the claims of such creditors would then stand extinguished once the Plan is approved.

Furthermore, issues that 'affect the rights of a third party who is not a party to the mediation proceedings' are not considered to be 'fit' for mediation under the First Schedule of the DMB.[62] Therefore, all stakeholders should be a part of such insolvency mediation. As per the Bill settlements which arise from discussions between the CoC and CD, excluding certain other creditors would be grossly unfair, since such decision would affect their ('third party') rights. Therefore, the parties involved in mediation must involve debtors, promoters, creditors of all classes and even resolution professionals.

Large Group Mediation

The paper duly acknowledges the associated difficulties that may arise from of dealing with a large number of stakeholders involved during mediation. However, it must be emphasised that such a problem shouldn't be considered to be relevant in all situations since the insolvent entity can also be a small partnership firm with relatively lesser number of creditors rather than a large company. Regardless, we believe that involving such a large group in the mediation shouldn't be considered odd or problematic in the latter situation. After all, the Lehman Brothers' bankruptcy was resolved through mediation, and large group mediations are not rare nowadays, especially since certain disputes involve several 'interest' groups.[63]

Despite large group mediations taking slightly longer to set up than their standard two-party equivalents, detailed planning and preparation can help in participants feel included and promotes confidence in the mediators and the process. Identifying all persons involved or affected is the first and most essential task in any mediation, especially with big groups. This crucial step ensures that all essential stakeholders, including decision-makers and anybody who might be affected by any agreements reached during the session, are included.[64] Pre-litigation mediation will therefore take place between all stakeholders. Once all stakeholders are identified, we propose that large 'interest groups' (such as instances wherein there could be hundreds of operational creditors) form representatives for their class to streamline the process while still ensuring proper representation of their concerns. Therefore, it is not only important to ensure representation for all stakeholders, but also to balance participation such that no group is overrepresented or underrepresented. Additionally, we propose that since the DMB promotes online mediation, the entire procedure for large group mediations could be cost-effective and viable.

Another apprehension of mediation could be that the participants may be hesitant to engage in compromise and dialogue with individuals who they perceive as adversaries. Sometimes, decision-makers can come to mediation reluctantly, especially when mandated mediation is involved. They are pessimistic about their chances of success and disengaged from the process. In that case, it is the mediator's responsibility to establish a process that allows the parties to understand the advantages of a self-determined, mutually agreeable solution. For instance, pre-mediation trainings such as warm-up exercises have been employed successfully in large multi-party conflicts.[65] If this turns out to be unfruitful, the DMB does allow the parties to back out of mediation after the first two meetings and proceed with litigation. Therefore, employing mediation as such would not cause unnecessary delays in the insolvency regime. As to who can be a mediator, the parties could either rely on the system of institutional mediation promoted by the Bill and ensure that a separate panel of mediators be available for insolvency matters, or even choose professionals, lawyers or judges with expertise in insolvency matters.

Finally, it is interesting to note that the Bill even provides for community mediation for residents or families of any area under Chapter X. If there can be a viable framework for such community mediation to occur, the possibility of altering such framework to suit the needs of large group insolvency mediation should not be ruled out. Insolvency mediation involving all the stakeholders would encourage everyone with an interest and who is prepared to co-operate to participate in the process. This would ultimately help achieve the objective behind mediation, which is aimed at fostering and maintaining consensus, based on principles of fairness, openness and trust. Therefore, allowing the participation of all relevant stakeholders should be considered to be a positive trait of insolvency mediation, rather than a challenge.

Cross-border Insolvency Mediation

In March 2018, the Ministry of Corporate Affairs' 'Insolvency Law Committee (ILC)' issued its first report, which proposed revisions to the IBC based on the Code's previous implementation results.[66] The Committee stated that the Code's existing provisions (u/s 234 and 235) do not supply a coherent model for cross-border insolvency.[67] It advocated for the development of a complete framework in this regard, based on the UNCITRAL Model Law on Cross-Border Insolvency, 1997[68] ('the Model Law') and made suitable recommendations to adapt it for India.

Outlining some important advantages of adopting it, the Report highlighted that such adoption might boost foreign investment by expanding the number of routes for international insolvency processes to be recognised, as well as increasing cooperation and communication between domestic and foreign courts and insolvency specialists. Furthermore, the robustness of India's financial sector reforms will send a strong signal to investors, governments, international organisations, and multinational firms worldwide. Second, the Model Law is intended to be adaptable and to take into account the diversity of national insolvency laws.[69] Third, the Model Law includes a comprehensive structure for international and domestic coordination between courts and insolvency practitioners. This would enable quick and efficient conduct of concurrent proceedings. Finally, the Committee concluded that including cross-border bankruptcy rules would result in a globally harmonised and complete insolvency framework for CDs, which is critical in today's globalised world.

So why is this Report relevant to Insolvency mediation in India? It has been cited to establish the concurrence of opinion between the Ministry of Corporate Affairs and its aforementioned Committee on the credibility and viability of the UNCITRAL Model Law. This is extremely important, because we believe that mediation can be a powerful tool to resolve cross-border insolvency issues. Creditors having conflicting claims may reside in different jurisdictions. In such situations, the involvement of varying insolvency regimes causes several coordination challenges.[70] A mediator can help parties involved in concurrent insolvency processes develop a protocol for cross-jurisdictional collaboration and coordination, as well as aid courts in narrowing and resolving substantive disagreements. It is critical to highlight that the appointment of a mediator on this basis falls well within the scope of Article 27(a) of the Model Law.[71] It contemplates the 'appointment of a person or body to work at the court's direction'. Such an appointment would fulfil the courts' commitment under Article 25 – 'to cooperate with foreign courts and foreign representatives to the greatest extent possible'.[72] Going forward, more courts may investigate mediation as a viable means of cooperation with successful outcomes in complex cross-border issues.

Moreover, it is believed that the changes of court procedural rules in local jurisdictions can promote the efficiency of this procedure, by giving courts the authority to compulsorily refer parties to pre-litigation mediation at any stage during the insolvency procedure. In this context, for India, the DMB, 2021 becomes relevant here because of its mandate for pre-litigation mediation. Since the DMB, under Part I and III recognises not only domestic but also international mediation,[73] cross-border insolvency mediation under it would have no obstacle. Finally, with Chapter IV allowing mediation service providers to appoint anybody – even a foreigner to be a mediator, "the appointment of a person or body to act at the direction of the court" under the Model Law runs in concurrence with the DMB.

Mediation in cross border matters is still in its infancy. However, with the ILC Report finding new ways to devise an efficient framework in India for cross- border insolvency, establishing mediation for the same should also be considered – especially in light of the already existing mechanisms in play (such as the ILC, the UNCITRAL Model Law and the DMB, 2021).

ADDRESSING CHALLENGES WITH REGARD TO IMPLEMENTATION

In addition to proposing an implementation plan for mediation insolvency in India, this paper will also address the challenges that may arise in this regard. The paper will determine the most suitable and appropriate model to be implemented in order to suit the Indian insolvency regime.

Mandatory Pre-Litigation Mediation

As is the common misunderstanding regarding mandatory mediation, mandatory mediation does not imply mandating dispute settlement via mediation. Mandatory mediation refers to mandating the 'attempt' of resolving any dispute through mediation. The parties are required to mandatorily give mediation a chance. Mandatory mediation can be done either before or after the institution of proceedings. If it's done prior to the proceedings, then the nature is of 'mandatory pre-litigation mediation'. Mandatory mediation can be provided for in different modes. One of these modes is legislative and involves mediation a prerequisite to initiating legal proceedings in a court.

In India, attempts have been made previously to make mediation statutorily mandatory. The Commercial Court Act, 2015 underwent an amendment in 2018 to incorporate mandatory pre-institution mediation.[74] In the case of *Afcons Infrastructure v. Cherian Varkey Construction Co Ltd*,[75] the Supreme Court while laying down principles governing reference of pending disputes to ADR, held that parties' consent is required only when their issue is referred to arbitration or conciliation, not for other means of dispute resolution, such as mediation.DMB also provides for mandatory mediation. Section 6 (1) of the DMB,[76] makes it mandatory for the parties involved in the dispute to attempt pre-litigation mediation as provided for in the DMB before initiating a proceeding or lawsuit in a court of law. As per the Bill, the pre-litigation mediation can be executed 'irrespective of the existence of any Mediation Agreement.'

While the provision mandating pre-litigation may attract numerous criticisms, it is also important to understand the necessity of the same. Although mediation is a quick, economical and efficient way of resolving any dispute, Indian parties have not been reaping its potential to the fullest. The Bangalore Mediation Centre was referred 31,441 cases between the time period of 2011-2015. This figure constituted 4.29% of all freshly instituted cases in the Bangalore High Court.[77] The Mediation and Conciliation Centre of the Delhi High Court was referred 13,646 cases for mediation during the same time period. This figure amounted to 2.66% of all cases in the Delhi High Court.[78] As for the Allahabad High Court Mediation and Conciliation Centre, 11618 cases were referred for mediation during 2011-15. This figure was 0.85% of all cases freshly instituted in the Allahabad High Court.[79] The data shows the extremely low number of cases that are referred for mediation. There are numerous factors responsible for this, like lack of awareness and inclusion as part of legal studies, qualified mediators, clarity on enforceability of cross border settlements, etc.

This is why mandatory mediation is justified and useful. There is a lack of mediation culture in India and making pre-litigation mediation mandatory will help the disputing parties to understand and get familiar, eradicating their hesitation of trying mediation as an alternative to court proceedings. The provision mandating pre-litigation mediation can be useful for insolvency cases. While some may argue that mandating mediation is antithetical to the very principle of voluntariness of mediation, it is important to understand that mandating an attempt at mediation does not make the process of mediation involuntary altogether. The DMB has particularly taken care of this concern by providing section 20 (1) which gives the disputing parties involved an option to 'withdraw from mediation at any time after the first two mediation sessions'. This gives the parties concerned the freedom to discontinue the mediation process in case it fails to make progress and yield any result. Therefore, pre-litigation mediation will not be detrimental to the insolvency resolution in any way. Rather, it will encourage the active participation of the parties to attempt negotiate and come up with an amicable settlement in an efficient manner. The CD and creditors involved will be required to make a good-faith effort to reach a settlement. If an aggregable settlement cannot be reached, then they will be free to cease the process and initiate legal proceeding in courts of law.

Binding Mediation and Provision for Appeal

One of the most important characteristics of mediation is that it is primarily a non-binding process.[80] However, in India, section 28 of the DMB[81] establishes that the Mediated Settled Agreement 'after domestic and international mediation shall be final and binding on the parties.' It is enforceable in line with the Code of Civil Procedure, 1908,[82] with an equal standing as a judgement or decree issued by a court. As per section 22 of the DMB, 'Mediated Settled Agreement' is 'the settlement in writing reached between some or all of the parties resulting from mediation, including online mediation.'[83] It must be authenticated by the mediator. Therefore, the issue of non-compliance with the terms agreed in the settlement shall not arise in insolvency mediation.

It is important for such a settlement be binding and enforceable, so that the efforts of both parties should not go in vain. As stated earlier, section 20 does allow the parties to withdraw from mediation at any time after attending two mediation sessions.[84] Therefore, if both parties have continued mediation and reached a settlement, it should be honoured and must have a place in the legal system. One possible challenge could be that the DMB, under section 29 allows for challenging the mediated settlement agreement on certain grounds.[85] However it must be noted that such an appeal can be filed only within ninety days of receiving a copy of the mediated settlement agreement, based on limited grounds. Therefore, the provision for appeal is time-bound and concurrent with the objective of the legislature to ensure that insolvency procedure runs on strict timelines, while also allowing challenge to the settlement in instances of gross injustice.

CONCLUSION AND SUGGESTIONS

The IBC has proved to be a revolutionary structural reform for the nation's economy as a whole. Unlike the previous regimes which could take as much as 4.3 years to close an insolvency proceeding, the Code has indeed compressed timelines for resolution of CIRPs. However, there is still room for improvement, and we must address issues such as the associated pitfalls of litigation and inadequate representation of all creditors. If further changes such as introducing pre-litigation mediation are executed successfully, the business sector in India, as well as the overall economy can benefit significantly.

The paper has elaborately dealt with the viability of mediation in the insolvency regime. The study of insolvency mediation across different jurisdictions outside India has helped understand the working of the same in countries who have already enforced it. The observations made gives an idea of the different ways in which insolvency mediation can be brought in force and the viability and suitability of each type in Indian context. Based on the observations made throughout the study, the authors recommend the introduction of insolvency mediation in India. With the formation of DMB, it is the most appropriate time to consider the required changes in current existing insolvency regime in India and include mediation as a part of it to make it more robust and efficient. The Bill contains different provisions that makes incorporating mediation as a tool to resolve insolvency disputes viable. Therefore, we suggest amending the IBC and incorporating mediation within the Code with the help of DMB. Even if insolvency mediation fails and CIRP is initiated under the IBC, there can be advantages such as better communication/ understanding between the stakeholders.

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SECTION 32A OF INSOLVENCY AND BANKRUPTCY CODE, 2016:

CONUNDRUM OR PROTECTION

— Vishal J. Dave and Mayur Jugtawat

Executive Summary

Section 32A was added through 2019 amendment which gives immunity to corporate debtor (CD) and its assets from the proceeds of crime and any criminal liability arising from the offences of erstwhile management for the offences committed prior to initiation of corporate insolvency resolution process (CIRP). Despite Hon'ble Supreme Court upholding constitutional validity of section 32A of the Insolvency and Bankruptcy Code, 2016 (the Code / IBC) there exists dispute with respect to execution of the provision with other legislations such as the Prevention of Money Laundering Act, 2002 (PMLA). Given the ambiguity and vagueness surrounding section 32A, the courts are indeed grappling with how to interpret it. Section 32A intends to separate any obligation linked with the CD, as well as their property and assets, in order to prevent their attachment or confiscation, which would negate the Code's purpose. By improving the insolvency framework to achieve a positive economic outcome, the IBC hoped to make it easier for applicants to commence over with a new start without fear of previous violations. The legislature's introduction while enacting section 32A was to safeguard the interest of stakeholders however the interpretation of the same lead to chaos between laws. Legislature is required to identify the jurisdiction of Adjudicating Authorities (AAs) for speedy disposal of matters. The amendment provision is a radical transformation that maintains the proactive legislative efforts taken to address the current challenges in resolving bad named firms by granting immunity in accordance with section 32A which makes cleaner transactions, resulting in higher bids and a more investor-friendly environment. Since the issue is pending before Hon'ble Supreme Court, lot depends on the interpretation that will be taken by the Apex court.

Keywords: Section 32A, PMLA, IBC, Enforcement Directorate

INTRODUCTION

Six years down the line, working of the IBC is required to be analysed in terms of what happens under the IBC, on account of it and within its shadow. The first order objective of the Code is resolution. The second order objective is maximisation of value of assets of the firm and the third order objectives are promoting entrepreneurship, availability of credit and balancing the interests of stakeholders. This order of objectives is sacrosanct.[1] The process involves number of stakeholders who divulge into a procedure to make best revival proposal for a distressed CD or put the CD into death bed by way of putting it into liquidation.

The IBC is a crucial reform in the Indian legal system as well as economic system. If implemented effectively and in a time bound manner can produce major gains for the economy as well corporate industry. The Code tries to divest the powers of management to Resolution Professional (RP)/ Liquidator who tries to run the company as going concern. The IBC is considered to maximise the value of assets, promote entrepreneurship and enhances availability of credit and most importantly balances interests of all the stakeholders. However, any law of the land is driven by lacunas and grey areas which further creates important question of laws to be decided by court of law.

One such scenario under the IBC is difficulty faced under section 32A of the IBC which provides protection to successful bidders/Liquidator when the CD is sold under CIRP or liquidation process. The intent of lawmakers was clear but execution of the same in practical scenarios has created hurdles for RPs, Liquidator, resolution applicants, successful bidders, banks, financial institutions and other stakeholders who are connected with process under the IBC.

SECTION 32A AND REQUIREMENT OF AMENDMENT

That the IBC is a developing law and need to interpret the provisions of law shall arise when a practical situation arises, or the stakeholders face difficulty in smooth functioning of the process. When the CD is taken over during CIRP or liquidation process, resolution applicant/successful bidder shall have expectations that the debt-ridden companies must be provided with a clean slate to start the business from the scratch. However, there always exists statutory hurdles which paves the way to make the entire process more difficult and cumbersome. One such issue came in the matter of JSW Steel Limited v. Mahender Kumar Khandelwal and Anr.[2] wherein a month after National Company Law Tribunal (NCLT) Delhi approved JSW Steel's successful resolution plan, the Enforcement Directorate (ED) provisionally attached assets worth ₹4025 crore in October 2019. The National Company law Appellate Tribunal (NCLAT) stayed both the resolution plan approval and the attachment order on appeal. Even so, the ED refused to release the attached assets and continued to contend that a direction to do so must be obtained from the relevant adjudicator under the PMLA. Bhushan Power and Steel Limited's (BPSL) committee of creditors (CoC) then moved to Hon'ble Supreme Court for relief, which granted an interim stay on the attachment in December 2019. When the matter was pending before Hon'ble Supreme Court an ordinance was passed with respect to introduction of section 32A.

The Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019, *inter alia*, provided for insertion a new section 32A so as to provide that the liability of a CD for an offence committed prior to the commencement of the CIRP shall cease under certain circumstances. The need for a protection arises in the interest of stakeholders and the major reason for bringing such reform is to protect the new management who has taken control of the CD. The fate of successful resolution applicant cannot be fettered away after its resolution plan has been accepted. The object is to ensure that a successful resolution applicant starts of on a fresh slate. The 'OBJECTS AND REASONS[3]' of the ordinance with respect to ordinance states that;

> A need was felt to give the highest priority in repayment to last mile funding to corporate debtors to prevent insolvency, in case the company goes into corporate insolvency resolution process or liquidation, to prevent potential abuse of the Code by certain classes of financial creditors, to provide immunity against prosecution of the corporate debtor and action against the property of the corporate debtor and the successful resolution applicant subject to fulfilment of certain conditions, and in order to fill the critical gaps in the corporate insolvency framework, it has become necessary to amend certain provisions of the Insolvency and Bankruptcy Code, 2016.

The ordinance was passed with effect from December 28, 2019 inserting following provision of law:

> 32A. (1) Notwithstanding anything to the contrary contained in this Code or any other law for the time being in force, the liability of a corporate debtor for an offence committed prior to the commencement of the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted for such an offence from the date the resolution plan has been approved by the Adjudicating Authority under section 31, if the resolution plan results in the change in the management or control of the corporate debtor to a person who was not—
>
> (a) a promoter or in the management or control of the CD or a related party of such a person; or
>
> (b) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession, reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court:
>
> Provided that if a prosecution had been instituted during the corporate insolvency resolution process against such corporate debtor, it shall stand discharged from the date of approval of the resolution plan subject to requirements of this sub-section having been fulfilled:
>
> Provided further that every person who was a "designated partner" as defined in clause (j) of section 2 of the Limited Liability Partnership Act, 2008, or an "officer who is in default", as defined in clause (60) of section 2 of the Companies Act, 2013, or was in any manner in charge of, or responsible to the corporate debtor for the conduct of its business or associated with the corporate debtor in any manner and who was directly or indirectly involved in the commission of such offence as per the report submitted or complaint filed by the investigating authority, shall continue to be liable to be prosecuted and punished for such an offence committed by the corporate debtor notwithstanding that the corporate debtor's liability has ceased under this sub-section.
>
> (2) No action shall be taken against the property of the corporate debtor in relation to an offence committed prior to the commencement of the corporate insolvency resolution process of the corporate debtor, where such property is covered under a resolution plan approved by the Adjudicating Authority under section 31, which results in the change in control of the corporate debtor to a person, or sale of liquidation assets under the provisions of Chapter III of Part II of this Code to a person, who was not—
>
> (i) a promoter or in the management or control of the corporate debtor or a related party of such a person; or
>
> (ii) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court.
>
> Explanation. —For the purposes of this sub-section, it is hereby clarified that, —
>
> (i) an action against the property of the corporate debtor in relation to an offence shall include the attachment, seizure, retention or confiscation of such property under such law as may be applicable to the corporate debtor;

(ii) nothing in this sub-section shall be construed to bar an action against the property of any person, other than the corporate debtor or a person who has acquired such property through corporate insolvency resolution process or liquidation process under this Code and fulfils the requirements specified in this section, against whom such an action may be taken under such law as may be applicable.

(3) Subject to the provisions contained in sub-sections (1) and (2), and notwithstanding the immunity given in this section, the corporate debtor and any person who may be required to provide assistance under such law as may be applicable to such corporate debtor or person, shall extend all assistance and co-operation to any authority investigating an offence committed prior to the commencement of the corporate insolvency resolution process.]

CONSTITUTIONAL VALIDITY OF SECTION 32A[4]

Section 32A firstly was challenged before Hon'ble Madras High Court in the matter of *Deputy Director v. Asset Reconstruction Company*[5] wherein following observations were made by the Court with respect to attachment of property by ED under the PMLA:

(a) The amendment made by way of insertion through section 32A of the IBC will not help the case of the respondents. It is prospective in nature apart from having no application.

(b) There is no cause of action before the Tribunal. All the banks are situated at Chennai, proceedings have been initiated by the petitioner at Chennai and so also the order of attachment.

(c) Section 32A of the IBC deals with the liability for prior offences. This provision would get attracted in a case where the resolution plan has been approved by the AA under section 31 of the IBC.

(d) The NCLT is not even a Civil Court, which has jurisdiction by virtue of section 9 of the CPC to try all suits of a civil nature excepting suits, of which their cognisance is either expressly or impliedly barred. Therefore, the NCLT can exercise only such powers within the contours of jurisdiction as prescribed by the statute, the law in respect of which, it is called upon to administer.

(e) An order of attachment under the PMLA is not illegal only because a secured creditor has a prior secured interest (charge) in the property, within the meaning of the expressions used in the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act). Similarly, mere issuance of an order of attachment under the PMLA does not ipso facto render illegal a prior charge or encumbrance of a secured creditor, the claim of the latter for release (or restoration) from the PMLA attachment being dependent on its bonafide. Thus, it was held that the NCLT has got no jurisdiction to go into the matters governed under the PMLA.

Before the section 32A could take its shape under the IBC, group of allottees had challenged the constitutional validity of the provision on the ground that it is arbitrary and violative of sections 14, 19, 21 and 300A of the Constitution of India.

Having regard to the object of the Code, the experience of the working of the Code, the interests of all stakeholders including most importantly the imperative need to attract resolution applicants who would not shy away from offering reasonable and fair value as part of the resolution plan if the legislature thought that immunity be granted to the CD as also its property, it hardly furnishes a ground for Hon'ble Supreme Court to interfere. The provision is carefully thought out. It is not as if the wrongdoers are allowed to get away. They remain liable.

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. We must also not overlook the principle that the impugned provision is part of an economic measure. The reverence courts justifiably hold such laws in cannot but be applicable in the instant case as well. The provision deals with reference to offences committed prior to the commencement of the CIRP. As far as protection afforded to the property is concerned there is clearly a rationale behind it.

The new management cannot be the subject matter of an investigation which has resulted in material showing abetment or conspiracy for the commission of the offence and the report or complaint filed thereto. The court held that as far as property is concerned there is a clear rational behind it and therefore court did not see any arbitrariness in the provision.

CLASH OF LAWS - IBC AND PMLA: WHAT PREVAILS OVER WHAT

The clash of the IBC and the PMLA is analysed in detail in the judgment of *Nitin Jain Liquidator of PSL Limited v. Enforcement Directorate* Through, Raju Mahawar Asst. Director PMLA.[6]

Petitioners' submissions

The Petitioner contended that the jurisdiction and authority of the respondent under the PMLA is legislatively mandated to cease once a resolution plan is approved by the AA or the sale of liquidation assets commences. It is further contended that section 32A clearly mandates that no action shall be taken against the properties of the CD, once a resolution plan comes to be approved or the CD undergoes liquidation.

Enforcement Directorate's submissions

ED contended that alluding to the provisions made in the PMLA, it is contended that the IBC cannot be an amnesty route for the accused under the PMLA and that if such sales under the IBC were permitted to hold, the entire confiscation regime under the PMLA and its objectives would be defeated and it was also contended that the provisions of the IBC cannot be accorded any primacy over the PMLA and that, consequently, notwithstanding the steps taken under that enactment by the petitioner here, the right of the respondent as conferred by the PMLA to move against the assets of the CD, to follow the proceeds of crime and consequently confiscate properties stands preserved.[7]

Decision and Conclusion

The Hon'ble High Court in the matter held as follows:

> ......P. The issue of creation of an offense or its nullification is a matter of legislative policy. An offense or a crime, on a jurisprudential or foundational plane, must be founded in law. Manoj Kumar has duly taken note of this aspect when it held that the creation or cessation of an offense is ultimately an issue of legislative policy. The Parliament upon due consideration deemed it appropriate and expedient to infuse the clean slate doctrine bearing in mind the larger economic realities of today. Q. Regard must also be had to the fact the cessation of prosecution stands restricted to the corporate debtor and not the individuals in charge of its affairs. The PMLA and its provisions stand steadfast and do not stand diluted in their rigour and application against persons who were in control of the corporate debtor. It was this delicate balance struck by the Legislature which met approval in Manish Kumar.... The power to attach as conferred by Section 5 of the PMLA would cease to be exercisable once any

> one of the measures specified in Regulation 32 of the Liquidation Regulations 2016 comes to be adopted and approved by the Adjudicating Authority. S. The expression —sale of liquidation assets must be construed accordingly. The power otherwise vested in the respondent under the PMLA to provisionally attach or move against the properties of the corporate debtor would stand foreclosed once the Adjudicating Authority comes to approve the mode selected in the course of liquidation. To this extent and upon the Adjudicating Authority approving the particular measure to be implemented, the PMLA must yield...

The Court also bears in mind that the bar that stands created under section 32A operates and extends only insofar as the properties of the CD are concerned.

The above issues held by the court does favour the CD under the IBC, but it does not absolve the liabilities of private individuals who can be prosecuted under the PMLA. This makes sure that the individuals do not get rid of the liabilities against the mechanism provided under the IBC. The judgment has made a distinctive analysis of both the laws and therefore it can be concluded that the sanctity of law in both spheres of law are intact to maintain harmonious interpretation of legislations. The scheme under both the laws are required to be read together for better implementation of laws.

PRACTICAL DIFFICULTIES AND REALITY CHECK

Bhushan Power and Steel Limited

ED attached assets worth ₹ 1.74 crore in alleged bank fraud case.[8] The ED raided the Resolution Professional (RP) in the matter of BPSL, Mahender Kumar Khandelwal for allegedly helping the former promoters of the company in clandestinely clearing finished goods for which he was paid in cash.[9] In the present case ED directly encountered with RP who is considered officer of the court. Along with the above-mentioned alleged fraud it was also alleged that RP helped suspended management to clear finished goods worth ₹ 700 crore and received payment in cash. This whole issue arose when JSW Steel's plan was approved by CoC, and Supreme Court was considering immunity to be provided under section 32A.

BPSL was one such case which triggered importance of section 32A under CIRP/liquidation. The attachment order came after seven months when JSW's resolution plan was approved. JSW sought immunity under section 32A, however on the same time ED with full force objected such protection and pleaded that section 32A is not applicable on ED's attachment. However, Hon'ble NCLAT gave relief to resolution applicant by giving order to de-attach the properties of CD. The ED moved against such order of Hon'ble NCLAT to Supreme Court.

PSL Limited

In above captioned matter Delhi High Court stated that attachment under the PMLA will be stayed once the liquidation process under the IBC is commenced. In this case also RP being officer of court was summoned by ED while investigating the affairs of the CD. It is pertinent to note that RP is duty bound to corporate with the investigating agencies however ED does not have power to prosecute RP as the appropriate authority for any grievance against RP is the Insolvency and Bankruptcy Board of India.

While CD being under CIRP, the RP was troubled for the wrong doings of the suspended management. Therefore, the RP filed an application before Hon'ble Delhi High Court arguing that ED's jurisdiction under the PMLA cease to have effect once the resolution plan is passed as provided under section 32A which bars prosecution, attachment, seizure, action or confiscation against a CD after a resolution plan is approved.[10]

The ED appeared before Delhi High Court and argued that powers given under the PMLA cannot be fettered away by the provisions of the IBC and the ED can continue to prosecute company until and unless assets are sold, and sale certificate issued. This submission of ED was dismissed by the High Court in light of section 238 of the IBC and keeping in mind objectives and purpose of the legislation.

It is interesting to read that the Hon'ble High Court distinguished between the two laws stating that the PMLA is criminal in nature to the offence of money laundering and confiscation of properties however the IBC is concerned with resolution of CD in time bound manner. The Court further, went on to held that both the legislations discharge their respective duties, obligations and responsibilities and in case of conflict, court must interpret law in most harmonious way.

The High Court held that section 32A is applicable for CD only and not the individuals who were incharge of the company who happens to be real offenders under the PMLA. The High Court wanted to ensure that insolvency and liquidation proceeding must be conducted in time bound manner with the objective to resolve the CD's distress. With such observations, the High Court directed the Liquidator to proceed with PSL's liquidation process in accordance with the IBC, while restraining the ED from taking any further action against the company's properties.

Sai Infosystem (India) Limited and Atrium Infocomm Pvt. Ltd.

Sai InfoSystem (India) Ltd which was considered to be an I.T. Company and also one of the platinum sponsors of the high-profile vibrant Gujarat summit is turning out to be another Satyam scam. The promoters of the company who allegedly committed ₹ 1400 crore fraud dragged the feet of investigating agencies while conducting the probe of such scam. Even the employees of the company were unpaid. Shri Sunil Kakkad, Chairman and Managing Director reportedly siphoned off money to the fraud the lenders which are SBI, SBBJ, IDBI, BOB and Allahabad Bank. After committing such fraud, the Managing Director fled India to rescue himself from conviction. Atrium Infocomm Pvt. Ltd., one of the units of Sai InfoSystem is also a part of such big scam. As on today both the companies are in liquidation. However, the properties of the company are attached by the ED which is creating a hurdle for smooth functioning of liquidation process.[11]

The agency issued a provisional order for attachment of 37 immovable properties of Sai InfoSystems (India) Ltd. and others under the PMLA.[12] The total value of the freezed assets is ₹ 56.21 crore. It is interesting to see that assets freezed even if recovered is beyond the credit facilities taken by the company. It has come into knowledge that the credit facilities availed by the company were based on false and fabricated documents which again raises the question upon banks and their due diligence process to grant such amount of loan without adequate documents. As per investigating agencies, the promoter had incorporated various shell companies and these firms were used for layering of money and for purchase of various immovable properties.

M/s. Sai InfoSystem (India) Ltd., M/s. Atrium Infocomm Pvt. Ltd. and M/s. Click Telecom Pvt. Ltd. based in Ahmedabad, generated 'proceeds of crime' to the tune of ₹ 867.43 crore which was also laundered by promoters. After years of chase promoter who fled to Liberia was intercepted by Interpol and was brought back to India. As on today when the company is still under liquidation and lot of employees who remain unpaid the questionable transactions still remain in grey area.

Intervention by Hon'ble NCLT

The company was sent under the process of liquidation in November, 2019 after banks and creditors initiated a process of bankruptcy and insolvency at the Ahmedabad bench of NCLT. The Liquidator also issued a notice for e-auction of some properties to recover debts of the company.

On August 7, the ED issued a notice to the Liquidator not to sell any property following which the official Liquidator filed a plea. Some of the immovable properties in the name of companies while under liquidation were auctioned by Liquidator. Now, as soon as ED came to know about such auction, they informed Liquidator that the properties are provisionally attached under the authority of the PMLA. Therefore, such auction is illegal. Both, the statues having difference sets purposes, Liquidator approached Hon'ble NCLT seeking director against ED for de-attachment of the properties, however Hon'ble Tribunal was of the view that there cannot not be any immediate relief for creditors and lenders of Sai InfoIystem (India) Limited. The Ahmedabad bench of NCLT has refused to entertain a petition for liquidation of assets of the company.[13] Hon'ble NCLT while dealing with the case made clear that jurisdiction under the IBC cannot interfere with the jurisdiction of the PMLA. The NCLT bench further observed that the Liquidator ought not to have started the e-auction as the matter was subjudice.[14] The same point of view has been taken by Hon'ble NCLT, Ahmedabad in the matter of Ardor Global Ltd.[15]

SECTION 32A: PROTECTION OR CONUNDRUM

Protection

The jurisprudence and interplay between two legislations is required to be balanced as both the legislations are equally important. The point of discussion herein is the doctrine of leges posteriorespriores contraries abrogant which says that when two legislative enactments contain non-obstante clause, the enactment later in time shall prevail. In terms of such doctrine the IBC shall always prevail. The question herein arises is whether the earlier enactment will have any essential role to play because of wall created by later enactment. It is pertinent to understand that section 32A is made for specific purpose and it does not harm the sanctity of the PMLA and therefore both the legislations are to be read with harmonious construction to derive smooth functioning and better execution of law. The point of intersection between two laws which contains non-obstante clause is section 71 of the PMLA and section 238 of the IBC.

The immunity of section 32A is premised on the conditions being fulfilled mentioned under section 32A(2) and the only bar from the exemptions or immunity of section 32A of the Code are these conditions only. The conditions under section 32A(2) for claiming exemption 'from actions' against the property of CD and the CD, are: -

(a) There must be approved resolution plan and change in control of the CD; and

(b) The new management cannot be the disguised avatar of old management and must not directly or indirectly involved in the commission of offence.

Acquired property through liquidation process under the provisions of Chapter III of Part II and is not old management or related to old management or directly/indirectly involved in commission of offence. Protection under section 32A can be understood through the difficulties faced by the companies in liquidation and CIRP. 'Action' includes attachment, seizure, retention or confiscation of such property under such law as may be applicable to the CD. The provision of 32A would get attracted in a case where the resolution plan has been approved by the AA under section 31 of the IBC. Therefore, when no such approval has taken place, the AA will not have any power or authority to exercise the power under section 32A of the IBC. This finding of Hon'ble NCLT, Ahmedabad bench has been upheld by Hon'ble NCLAT in *Kiran Shah, 'Resolution Professional' of KSL and Industries Ltd. v. Enforcement Directorate Kolkata*.[16] It is also held by court that purpose of two enactments (1) the IBC and (2) the PMLA even though at the first blush appear to be at logger heads, there is no repugnancy and inconsistency between them, in lieu of the fact the text, shape and its colour are conspicuously distinct and different, operating in their respective spheres.[17]

Protection Given by Court of Law

It is certain that underlying law in hand, section 14 and section 238 will come into picture while deciding any case. Any charge or attachment on the properties of the CD will be detrimental in the interest of the stakeholders and courts time and again have reiterated importance of the IBC over other laws. Non-obstante has been clearly held to be superseded by various courts and therefore the protection with respect to properties of the CD is absolute in nature.

Here we discuss about the protection given by court of law in the cases of Income Tax, GST Department and State Tax. The AAs have considered release of properties unfreezing of accounts which were made as sanctions under the prescribed laws.

Ram Ratan Modi (RP of Duncans Industries Limited) v. ICICI Bank[18]

Brief facts and Issue

Application was filed seeking direction from Hon'ble AA to release the lien/attachment over the current account on the direction of Employees' Provident Fund Organisation (EPFO) and Income Tax authority maintained with them being account no. 635405000368 in order to enable the RP herein to take control of the said accounts and carry out necessary transactions.

Decision

Section 238 of the Code makes it clear that the provision of the Code will override other laws. Moreover, upon enactment of the Code, several statutes were amended to that effect, Income Tax Act, 1962, being one of them, was also amended vide third schedule of the Code. The court further went on to held that when moratorium has been imposed and in action of section 238 of the IBC, not de-freezing the account would amount to antithetical and against the principle of equity. The court made an observation which is quoted as under:

> What pains us is to see such applications being filed so often even after the point of law stands settled in this regard. One of the objects of the Code is to conduct the CIRP in a time bound manner, therefore, to save the time, upon coming to knowledge of the order of admission of the corporate debtor into CIRP, the statutory authorities should withdraw their direction of attachment from the assets of the corporate debtor.[19]

In view of the above observations Hon'ble Tribunal allowed release of attachment entering into the jurisdiction of the EPFO and Income Tax Authority considering that the IBC will supersede such laws.

Ritesh Prakash Adatiya v. Deputy Commissioner of State Tax (Enforcement) Division-8 Surat [20]

Brief Facts and Issues

The application was filed by the Interim Resolution Professional (IRP) of the Electra Accumulators Ltd. requesting the AA to direct the GST Department for detachment of the properties attached by them, being in the form of 'Finished Goods', raw materials and the machineries belonging to the CD and to hand over to IRP of the CD and lodge the claim with the IRP. CD was a defaulter of the statutory dues of the Gujarat State GST Department of the amount of ₹ 2,05,41,236/-. State Tax Department provisionally attached/encumbered the below mentioned properties under powers given by section 83 of the Gujarat State SST Act 2017 and Central GST Act 2017 and launched proceedings under section 79 of the Gujarat State GST act 2017 and Central GST Act 2017 to determine and recover the tax or any other amount due from the defaulter.

Decision

The Hon'ble AA while considering the pain and trouble of the RP while conducting CIRP held that section 238 of the IBC will override Gujarat State GST Act 2017 and Central GST Act 2017 and directed Deputy Commissioner of State Tax to release the assets of the CD.

It is pertinent to mention that the same has been taken by Hon'ble NCLT, Ahmedabad bench in *Shri Ramchandra D Choudhary IRP for Neesa Leisure Ltd. v. Commissioner of income tax*.[21] When the interference can be made by Hon'ble AA in income tax and state tax matters for release of attachment of the properties, the same analogy can be drawn in the matters of attachment considering section 238 and objectives of the Code. Otherwise without such protection it becomes difficult for RP/Liquidator to manage the affairs of the CD and ultimately the objective of the Code which is to revive the CD falls as an untimely death.

Conundrum

Secured Property Vs. Attached property

In the matter of *The Deputy Director, Director of Enforcement Delhi v. Axis Bank and Ors.*,[22] the issue herein arises between banks mortgaged property and the same property attached by the ED. After due process of law has been initiate by the banks to recover money, the ED found out that this is case of money laundering and therefore attached the properties after taking confirmation from appropriate authority of law under the PMLA. It is pertinent to note that to claim the property third party needs to show a bonafide interest that it has acquired the property in lawful manner.

The bonafide third party claimant shall be accountable to the enforcement authorities for the 'excess' value of the property subjected to the PMLA attachment. If the order confirming the attachment has attained finality, or if the order of confiscation has been passed, or if the trial of a case under section 4 of the PMLA has commenced, the claim of a party asserting to have acted bonafide or having legitimate interest in the nature mentioned above will be inquired into and adjudicated upon only by the special court.

INTERSECTION OF LAWS: PMLA AND IBC

The moratorium provided under section 14 of the IBC is not extended to the promoters/directors/

personnel of the CD. Therefore, moratorium cannot come in the way of ED to investigate a person for the proceeds of crime. Criminal liability of a person will always be different from its civil liability. The creditors cannot be deprived of the actions of the person who has committed series of crimes. It has been held by the court that there is no inconsistency between the laws i.e. the RDB Act, the SARFAESI Act and the IBC.[23] The court placed judgment on the premise the only if there is any inconsistency between laws, non-obstante clause will come into picture. In the present scenario the PMLA has an objective to work upon 'proceeds of crime' while insolvency plays a role to revive the company. However, the process of attachment is in the nature of civil sanction which runs alongside criminal investigation. Section 71 of the PMLA provides for overriding of laws in cases of inconsistency. If the objectives of both the acts are not understood adequately then the purpose of both the acts shall fail.

Role of Various Authorities

PMLA and Enforcement Directorate

The PMLA establishes and enforcement agency under section 44 which has exclusive jurisdiction to try the offense of money laundering and connected issues thereto. It is pertinent to note that the PMLA functions on proceeds of crime for the offense of money laundering forming the essential part of law. The law acts upon principal of mens rea and actus reus.

The expression 'proceeds of crime' under the PMLA is defined by section 2(1) (u). The definition is exhaustive in nature which is restricted to the criminal activity defined under the act. The authorities are empowered to provisionally attach the property by virtue of section 5(1) of the PMLA. Thereafter, due procedure of law is followed for to arrest, search and seizure, attachment, confiscation, investigation, prosecution and all other proceedings under the PMLA. The ED has power to provisionally attach the property which is further subject to approval of AA under the PMLA. The 'attachment' is defined by section 2(1)(d) to mean prohibition of transfer, conversion, disposition or movement of property by an order issued under third Chapter of the PMLA. The confiscation of the property entitles state vested right over the property which is free from all the encumbrances.

The PMLA recognises 'legitimate interests' in properties attached by ED and gives opportunity of hearing as to why properties attached are not required to be made part of state. The same depends on factual circumstances and therefore third parties must ensure that their case is fit to be released in their favour. It is vivid that the legislature has made provision for 'provisional attachment' bearing in mind the possibility of circumstances of urgency that might necessitate such power to be resorted to. The authorities must assess the tainted properties in a manner which is restricted illicit gains of crime.

The PMLA is a special act which is focussing on process of crime, or the offenses conducted by individuals. Doctrine of lifting of corporate veil must be applicable making individual parties liable for the crime. The company remains a formal party who is having a separate legal entity. The duties and responsibility enshrined under the act are restrictive in nature. There seems to be new clash or intersection of provision in comparison to the IBC. The role of the PMLA is defined by its objectives which is different from the objectives of the IBC. Considering the upper stated procedure and penal action under law, the role is to unearth the crimes committed under this act.

Role of Investigating Agencies under Section 32A of IBC

There are several law enforcement agencies which look into the matters related to scams, financial frauds, scandals, forgery, corruption, terrorism etc. India has several investigating agencies like Serious

Fraud Investigation Office (SFIO), ED, Directorate General of Central Excise Intelligence, National Investigation Agency, Central Bureau of Investigation etc. These agencies have been provided with ample of powers, they can attach properties, and also empowered to criminally prosecute the offenders in the court of law. In case of financial frauds investigating authorities attach the properties of company as well as the personal properties of members of the management of the company.

In *Bhusan Steel Limited* matter, the SFIO arrested the promoter of the Bhusan Steel Limited i.e, Neeraj Singhal and alleged that he along with his officials by using hundred associate companies divert/ siphon off the funds of around ₹ 2000 to 3000 crore raised from the bank which ultimately cause wrongful loss to the banks and the investors of the company. The investigation is issued by the Ministry of Corporate Affairs under section 212(1)(c) of the Companies Act, 2013. The SFIO filed remand application on the ground that Neeraj Singhal, his father and Chief Financial Officer did not provide details and are not cooperating. Special Judge extended the judicial custody of Neeraj Singhal for 14 days and later on Neeraj Singhal applied for bail and bail was granted and he was released on bail.[24]

However, section 32A further provides that if investigating authority has a reason to believe based on the material in its possession that a person is in the new management of the CD and he has abetted or conspired for the commission of an offence and has submitted a report or filed a complaint against that person before the relevant authority or to appropriate court then liability of such person will continue and he can be prosecuted and punished for such offence.[25]

In *JSW Steel Limited v. Mahender Kumar Khandelwal & Ors.*, NCLAT (Company Appeal) (AT) (Insolvency) No. 957 of 2019,[26] appeal was filed by successful resolution applicant i.e. JSW Steel Limited challenging the jurisdiction of ED to attach the properties of the 'Bhusan Power & Steel Limited' after the change of the management. Hon'ble NCLAT observed that section 32A(1)(b) of the Code requires that investigating agencies on the basis of material that they possess at present, must have reason to believe that the resolution applicant had abetted or conspired for the offence. The phrase that 'on the basis of material in its possession' and use of the word 'have reason to believe' indicates that investigating agencies must possess material on the date when it calls for confirmation/ certification under section 32A(1)(b) of the Code. Mere assertion by investigating agency in their reply that they need to further investigate the matter to find or examine that whether there has been any abetment or conspiracy by the successful resolution applicant does not establishes that investigating agency has any material to believe that successful resolution applicant had abetted any offence and immunity under section 32A cannot be denied to the successful resolution applicant.

Further in *Nitin Jain liquidator of PSL Limited v. Enforcement Directorate*[27] Delhi High Court dealt with the question that whether the authorities under the PMLA, after initiation of liquidation of the CD, have jurisdiction or authority to proceed against the properties of a CD. The High Court observed that with the initiation of the liquidation the appointed Liquidator will step into the shoes of erstwhile management and has the custody of the CD assets including papers and documents. Therefore, it is the obligation of the Liquidator to provide full cooperation and provide all the material or information requires for investigation. And Liquidator cannot claim to be immune from answering the questions or to provide the documents or information asked by the investigating authorities.

NCLT

In the matter of *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta and Ors*.[28] the Supreme Court has settled the position of law by stating that the role of NCLT shall always be supervisory in nature as envisaged for it under the IBC, which sought to make the process driven by trained RPs. AA even after introduction of section 32A has been facing difficulties giving protection to RP/Liquidator in terms of protection.

Applications are filed under section 32A read with 60(5) of the IBC along with rule 11 of the NCLT Rules, 2016 seeking release of properties attached by the CD. If NCLTs do not interfere with the attachment by the ED, as per section 9 of the PMLA, the right and title of its owner vests as 'absolutely in the Central Government free from all encumbrances.' The issue herein concerns the sovereign authority of the state to attach and take away the property which are considered to be out of proceeds of crime in accordance with law and recover the money what is due.

Section 32A of the Code was inserted with the intention to provide the protection to the assets of the CD which have been financed by the creditors of the CD. Section 32A provides that the liability of the CD shall ceases and CD shall not be prosecuted after the approval of resolution plan by Hon'ble AA, for offences committed prior to the initiation of CIRP if resolution plan resulted in the change of management of the or control of the CD. Further no action is taken against the property of the CD with respect to the offences committed prior to the initiation of CIRP where such property is covered under the liquidation estate of the CD.[29] Therefore, NCLT becomes custodian to interpret the provision in rightful and justifiable manner.

EFFECTIVENESS OF SECTION 32A

The IBC was enacted on May 28, 2016, and the 2019 amendment added section 32A to the Code. This section specifies the exclusions to the immunity accorded to CDs for offenses committed during the CIRP term from the date of NCLT approval.

The objective and plan of the CIRP is to transfer the CD's corporation to a legitimate new resolution applicant. Any threat of attaching the CD's assets or subjecting the CD to proceedings by investigating agencies for the previous management's wrongdoing will defeat the CIRP's very purpose and scheme, which includes, among other things, the resolution of insolvency and the revival of the company, and the bank's efforts to realise dues from their non-performing assets will be derailed. New acquirers are 'not fools' to risk their money on enterprises that are in the process of going bankrupt. A clean asset is required by an acquirer. As per the spirit of the Code, an acquirer of a company can't be harassed by any agency in the process of such acquiring.

Section 32A: Is it an easy way out for CDs to safeguard themselves away from prison?

The CD and its assets have been granted exemption from an offense committed before the start of the bankruptcy process, thanks to the addition of section 32A to the Code. In other words, the CDs can pull in their horns previous management or promoters' wrongdoings. Furthermore, the exemption will only apply if the resolution plan has resulted in a change in the CD's management or control, which is relevant given the ambiguity surrounding the operation of non-obstante clauses. The immunity also extends to a CD's property or assets, which cannot be attached, seized, confiscated, or retained.

Following that, the clause passed the validity test in *JSW Steel Limited v. Mahender Kumar Khandelwal*,[30] the lawsuit that was thought to be the provision's reason for existence in the first place. While it was clear after court rulings and the addition of a broad section 32A that all claims are extinguished once the resolution plan is approved, there was still uncertainty about the legitimacy of statutory authorities' activities against the debtor prior to the start of CIRP. This arises a need to draw a line between offenses committed by CDs and the offenses committed by those running the CDs.

Effectiveness

Section 32A provides bidders who want to invest in disputed companies' properties and assets confidence. The Act's retrospective impact, which offers blanket immunity to the CD and their assets and properties, guarantees that the CIRP is closed as quickly as possible. This section has been instrumental in the resolution of several major cases, including *Bhushan Power And Steel Ltd v. S. L. Seal & Ors*.[31]

CDs were burdened with obligations and the inconvenience of prosecutions for past offenses prior to the enactment of the aforementioned section. As a result, there was a need to include a clause that relieved the CD of all liabilities so that they could move forward with the resolution process. This section's major goal is to give resolution applicants a fair chance to resurrect CDs without the risk of being held liable for past wrongdoings.

This non-obstante section, when read in conjunction with section 238 of the above-mentioned Code, has a beneficial overriding application. The broad scope of this rule begs the question of what kind of actions would fall under its purview. In the case of *Shah Brothers Ispat Pvt. Ltd. v. P. Mohanraj and Ors*,[32] the NCLAT correctly stated that any criminal processes, such as those under the Negotiable Instruments Act 1881, are not covered by this Code and so cannot be overruled by section 32A.

Now, to summarise the cumulative effect of the provision the following should be noteworthy:

(a) Although this provision remains relatively new, only a few cases have been used to test its effectiveness. However, the greater concern remains that in some scenarios, it may preclude the use of other agencies' remedies against the CD, and this needs to be seen. By virtue of this provision, the simple adoption of a resolution plan can trump legislative remedies available to others against CDs.

(b) Another significant difficulty that this rule could bring is that it could prevent the attachment of property obtained through illegal conduct. The CD may have acquired such an asset or property just before the CIRP started.

(c) Any action made to discharge the criminally acquired property or asset shall be invalidated by this section. Following the completion of the CIRP, any illegally obtained assets or properties would be legalised. The general application would also ensure that no legal action could be taken against the illegally acquired property in the future. The above-mentioned provision has a number of possible hazards that can only be detected and corrected by the courts.

One of the relevant decisions taken by the Delhi High Court to analyse and describe the ambit of section 32A is *Tata Steel BSL Ltd. and Anr. v. Union of India and Anr*.[33] wherein the court discharged the accused on the plain application of section 32A of proceedings filed against them for alleged offenses before the trial court under the Indian Penal Code 1860, the Companies Act 2013 and 1956, following the approval of the resolution plan for revival of the petitioner previously known as Bhushan Steel Ltd. under the IBC process.

CONCLUSION

In the *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*[34] and more recently in *Ghanashyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited*,[35] the Supreme Court emphasised the importance of erasing the CD's past liabilities, which ensures the assets' fair value. The Insolvency Law Committee Report, 2020, stated that the 'fear of liability falling on bona fide persons who buy the legal entity, could dramatically diminish the odds of its successful takeover by potential resolution applicants.'

The NCLAT is likely to refocus attention on the scope of the IBC's overarching authority under section 32A read with section 238 through *Directorate of Enforcement v. Manoj Kumar Agarwal*.[36] Although invoking section 32A isn't directly instructive in this case because the resolution plan hasn't been authorised, the goal underlying its inclusion must not be disregarded and must be followed in letter and spirit.

Given the ambiguity and vagueness surrounding section 32A, the courts are indeed grappling with how to interpret it. Section 32A intends to separate any obligation linked with the CD, as well as their property and assets, in order to prevent their attachment or confiscation, which would negate the Code's purpose. By improving the insolvency framework to achieve a positive economic outcome, the IBC hoped to make it easier for applicants to commence over with a new start without fear of previous violations.

The legislature's introduction while enacting section 32A was to safeguard the interest of stakeholders however the interpretation of the same lead to chaos between laws. Legislature is required to identify the jurisdiction of AAs for speedy disposal of matters. The amendment provision is a radical transformation that maintains the proactive legislative efforts taken to address the current challenges in resolving bad-named firms by granting immunity in accordance with section 32A. This will make it easier to make cleaner transactions, resulting in higher bids and a more investor-friendly environment.

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A CONTRIBUTION TO THE FRAMEWORK FOR ASSESSING OUTCOMES OF INSOLVENCY REGIMES

— *Gabriel Eduardo Messina*

Executive Summary

A well-functioning insolvency regime bring benefits that range from improving the size and deepness of capital markets, enhancing entrepreneurship and company formation, and contributing to faster, improving access to finance and more efficient adjustment of non-performing loans. On the other hand, inadequate insolvency regimes create uncertainty for creditors, generating greater difficulties for companies seeking to access credit.

Efficient and predictable insolvency and debt resolution frameworks are key drivers to improve financial inclusion which may lead to the reduction of the cost for obtaining credit. The legal framework governing corporate insolvency helps to determine how efficiently scarce resources are reallocated to more productive uses when a business encounters serious financial difficulties.

It is of great importance to estimate potential impacts of regulation and adopt such proposal which is most likely to achieve the objectives. Regulatory Impact Analysis (RIA) is a fundamental tool to help governments to assess the likely benefits, costs and effects of new or existing regulation.

This paper aims to point out some aspects of RIA, its usage and to introduce it into the Insolvency and Bankruptcy Code (IBC/Code) framework to address possible inconsistencies and systematise regulatory uniformity.

Keywords: Insolvency, Regulatory Impact Assessment, Framework

INTRODUCTION

The legislative or non-legislative solutions adopted by the State should address a maximum of economic, environmental, and social issues causing a minimum burden on business and community.

Having an efficient and effective insolvency regime is one of the ways through which the Government can seek to achieve these goals. It helps to create a business environment that supports growth and employment by ensuring that viable businesses in distress can be rescued.[1] Where businesses cannot be rescued, the insolvency regime should provide a low-cost procedure for liquidating businesses and returning funds to creditors quickly.

An appropriate design of regulatory policy and its effective application as an analytical and programmatic instrument, such as the evaluation of regulation effects, becomes very important.[2]

But it often happens that new regulations generate unwanted effects apart from reaching their real goal and it may be very difficult to predict or measure all these consequences without using dedicated instruments. Even a well-defined, individual regulation will often comprise a complex chain of interventions, interactions, and impacts.[3]

Accountability increases when governments commit to monitoring impacts of proposed regulations as well as evaluating them over time particularly when the regulators use impact assessments to analyse the coherence of proposed laws and regulations with medium to long-term policy goals.[4]

A range of Organisation for Economic Cooperation and Development (OECD) studies have connected a high cost to close a business (based on World Bank Doing Business indicators) to weak productivity outcomes, via less scope for productivity spill overs and the misallocation of labour, capital and skills.

The gains to aggregate productivity are magnified if the scarce resources once consumed by exiting firms – capital, labour, skills and ideas – can be reallocated to more productive uses. While this typically reflects the reallocation of tangible inputs, there is also scope for the post-exit diffusion of codified knowledge to new entrants via employee mobility and the sales of patents.[5]

In the case of India, the erstwhile Planning Commission's 12th five-year plan (2012-2017) recommended the employment of RIA for both existing and future regulations that affect the business environment in India. *Ex-post* analysis will ensure that the government is able to analyse the effectiveness of enforcement of regulations and lift regulation when it becomes unnecessary in a given market (invoking the sunset clause).[6]

Also, 2012 OECD recommendation on Regulatory Policy and Governance calls on governments to conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost justified, cost effective and consistent, and deliver the intended policy objectives.[7]

Finally, we must emphasise that this paper is far from being a comprehensive list of methods as our primary goal is simply to show that impacts can be assessed in different ways and that RIA may be not better or worse than another; it is rather the question of what aspect of the proposed solution you want to analyse at particular moment.[8] But we think that RIA can help in the study of the efficiency and effectiveness of the IBC.

DESIGN OF INSOLVENCY REGIMES AND IBC

Market imperfections, such as coordination problems, incomplete contracts and information asymmetries, call for insolvency procedures that facilitate the exit of failing firms in an orderly fashion.[9]

In India, the IBC, enacted and notified in the Gazette of India in May, 2016 became the single law that deals with insolvency and bankruptcy by consolidating and amending various laws relating to reorganisation and insolvency resolution. The IBC covers individuals, companies, limited liability partnerships, partnership firms and other legal entities as may be notified (except financial service providers) and is aimed at creating an overarching framework to facilitate the winding up of business or engineering a turnaround or exit.

The IBC aims at insolvency resolution in a time-bound manner. The Code requires resolution in a time bound manner as undue delay is likely to reduce the organisational capital of the company. The Code requires that a corporate insolvency resolution process (CIRP) shall mandatorily be completed within 330 days, including any extension of time as well as any exclusion of time on account of legal proceedings.[10]

The IBC provides for reorganisation to rescue a distressed company if its business is viable or close it if it is unviable, through a market driven process. In case of rescue, the company is reorganised as a going concern and the claims of creditors are restructured. In case of closure, the assets of the company are sold, and the proceeds are distributed to creditors.[11] The IBC entrusts the responsibility of reorganization of a stressed company to financial creditors not only because they have the capability to take business decisions and the willingness to restructure their claims, but also their interests are aligned with the interest of the company having going concern surplus, making it a positive-sum game.[12]

It has been remarked that one important trade-off in designing insolvency procedures concerns on the one hand, the incentives it provides investors to extend credit and to monitor firm performance, and on the other hand, the incentives it provides debtors to manage the firm efficiently and transparently. Insolvency regimes can promote efficient outcomes by providing these incentives: i) prior to insolvency when the firm is healthy (*ex-ante* efficiency); and ii) once the firm is in distress and enters insolvency (*ex-post* efficiency).[13]

Under the provisions of the Code, insolvency resolution can be triggered at the first instance of default and the process of insolvency resolution has to be completed within the stipulated time limit.[14]

The code also proposes a paradigm shift from the existing 'debtor in possession' to a 'creditor in control' regime.

To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures limiting court formalities to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected.[15]

Regulatory policies directly shape aggregate productivity along the exit margin through their impact on two key channels: i) the strength of market selection, which increases in the economy's ability to dispose of non-viable firms and by facilitating the restructuring of viable firms, holds out the prospect for higher within-firm productivity growth in the future; and ii) the scope and speed at which scarce resources consumed by failing firms can be reallocated to more productive uses.[16]

We propose the integration of RIA in the assessment suggested by the Insolvency and Bankruptcy Board of India's (IBBI) Working Group on tracking outcomes under the Code since RIA is systemic approach to critically assessing the positive and negative effects of proposed and existing regulations and non-regulatory alternatives.

Conducting RIA within an appropriate systematic framework[17] can underpin the capacity of governments to ensure that regulations are efficient and effective in a changing and complex world and is a process of systematically identifying and assessing the expected effects of regulatory proposals, using a consistent analytical method, such as cost/benefit analysis.

The RIA process is highly flexible and can adapt to the significance of impacts of the policy being examined or to topics of national interest.[18]

RIA

General remarks

While there are limits to the cumulative amount of regulation that governments can impose on society without having a negative effect on welfare, there is no practical regulatory budget constraint as there is for fiscal budget measures. Because of this, it cannot be assumed that regulators will necessarily limit their use of regulation as tool to achieve policy goals, even if regulation has not been demonstrated to be an efficient approach. Regulators play a vital role in delivering public policy, but without good governance arrangements such us the use of RIA, regulators do not have the tools or the incentives to examine whether an alternative approach to regulation may be a more efficient means of achieving a policy goal.[19]

RIA has now become a common tool in the regulatory policy process[20] but impact assessments are still rare in insolvency reform.

The first appearance of the RIA as a formal government requirement was in the United States. In 1981 one of the earliest acts of the Reagan Administration was to require each 'major' proposed federal regulations to be accompanied by an assessment of benefits and costs and an examination of alternatives to the proposed regulation. [21]

A well-designed RIA can assist in promoting policy coherence by making transparent the trade-offs inherent in regulatory proposals, identifying who is likely to benefit from the distributional effects of regulation and who will bear the costs, and how risk reduction in one area may create risks for other areas of government policy.[22]

RIA can also empower developing countries to assess and develop their own policies, rather than accept 'precooked' policies from elsewhere. However, despite some notable efforts to establish the methodology in a number of developing countries over a decade or more, RIA is failing to take root.[23]

The need for RIA in India was also highlighted by the Committee for Reforming the Regulatory Environment for Doing Business in India that submitted its report in 2013. It proposed that every regulatory authority, national or sub-national government, ministries or departments should have a Regulation Review Authority within itself tasked to undertake the RIA of all regulations proposed by the respective body.[24]

RIA is sometimes misconceived as a substitute for policy making, when in fact it is intended to facilitate and strengthen the policy process, by helping to assess whether regulations are needed and if they will be effective.[25] RIA is an evidence-based tool to support public decision-making. It is a systematic appraisal of how a proposed policy is likely to affect certain categories of stakeholders and a range of outcomes.[26]

With regard to policy coherence, RIA is a process of appraisal that involves stakeholders and diffuse interests and fosters transparency; introduces formal procedures for those who are affected by proposed regulations to exercise their right to be notified and to comment; and contributes to public accountability and scrutiny of executive action.[27]

As we have suggested, regulatory policy is a critical dimension of an enabling environment for investment and thus for economic growth and innovation.[28]

Indeed, the expected effects analysed via RIA may cover administrative burdens or basic compliance costs, or more complex types of costs and benefits, including environmental benefits, distributional effects, and the impact on trade. The scope of economic activities covered by RIA ranges from some types of firms to whole economic sectors, competitiveness and the overall economic impact of regulations.[29]

However, RIA should be proportional to the significance of the regulation. Policy makers should target RIA towards regulatory proposals that are expected to have the largest impact on society and ensure that all such proposals be subject to RIA scrutiny. The depth of the analysis should depend on the significance of the regulation being analysed. RIA, if carried out properly, takes time and resources.[30] But in the case of the IBC, given the importance of the regulation, is very likely that the costs will be less than proportional to the size of the impact.

It has been suggested that for regulations or laws with potentially important impacts on society or the economy (like the IBC) it is desirable to embed review requirements in the legislative/regulatory framework itself. In such cases, a review can be crucial to necessary 'learning by doing', as well as for ensuring that there have been no unintended consequences. Embedding a review in the enabling legislation means that the review is more likely to take place when needed and address the key issues of concern. Importantly, it also provides a public signal of the government's desire to achieve good outcomes.[31]

And before we address the methods, we must clarify that RIA is not Cost Benefit Analysis (CBA). CBA may be an occasional tool rather than the central component of RIA in developing countries. Complex quantification techniques do not need to be included in the design of RIA methodologies, at least in the first instance. The assessment of impacts does not have to be accurate. At the very simplest, RIA can help properly define the problem, go through the policy options, work through a simple check list of pros and cons, make some reasonable assumptions, and validate these with stakeholders before building this up towards a more complex model—which may or may not be completed.[32]

A well-done *ex post* analysis, moreover, is not limited simply to an examination of the effectiveness and cost of the regulations but can test other assertions made during the regulatory process.[33]

Also, and before embarking on designing and implementing a RIA process, policy-makers involved with regulatory management and policy issues need to consider whether there are basic pre-conditions for successful introduction and to what extend the existing institutions can provide a good framework for implementation.[34]

Specific techniques or methods for impact assessment

An appropriate definition of the regulation goal is a condition of selecting the method for its performance verification or measurement, and of selecting the methods for reaching this purpose. Definition must be precise and unambiguous. A right definition of the regulation purpose is the condition of determining the method for a verification or measurement of its implementation and for the selection of the goal achieving ways.

Determining which method to apply is a central element of RIA design and performance. Several RIA methods are commonly used in OECD countries. These include benefit/cost analysis, cost effectiveness or cost/output analysis, fiscal or budget analysis, socio-economic impact analysis, social discount rate, risk analysis, consequence analysis, compliance cost[35] analysis, and business impact tests.

The application of RIA in developing countries requires a particularly flexible analytical approach.[36] This is because the assessment is also an investment in scarce resources like time and qualified officers. At the same time, it is also an asset to build capacity in the public sector for data generation and evidence-informed policymaking, as well as for the emergence of robust consultation practices.[37]

Although there are many methods to do the task, we will dedicate a few lines to the most common ones.[38]

Standard Cost Model

Typically, costs are easier to characterise and quantify than benefits.[39] The Standard Cost Model (SCM) is used for the identification and measurement of administrative burdens and direct compliance costs.[40]

The SCM analysis means that resources necessary to fulfil regulatory requirements demanding to provide information are expressed in monetary terms. In that way SCM helps to understand in which direction it is more necessary and more useful to concentrate simplification measures because the formula allows seeing which variable is the most burdensome in monetary terms (within one year).[41]

Cost benefit analysis

CBA consists in calculating the overall, total benefit resulting from a specific regulation in relation to the total cost, and in comparing these to the general cost of regulatory action. This is one methodology that has been applied successfully but the complexity of the methodology varies across countries and even within countries.[42]

We can identify some plusses of the CBA method: a) transparency and clear responsibility; b) existence of single unit of value in both cases, for expenditures and for revenues; c) comparability – policy outcome is easy to connect to society's benefits, it is possible to compare a variety of programs based upon single basis.

However, there are some disadvantages of the CBA: a) conduction of full CBA is complicated and time consuming (especially computing income in monetary value, for example estimating the monetary value of human life); b) there is a risk of careless, naive or dishonest use of method; c) is on economic efficiency, the method does not take into account the principles of equality and appropriateness.[43]

Break-even analysis

In many cases, the type of the benefits expected to derive from a regulation will be clear, but the regulation's likely effectiveness in generating those benefits will be subject to much uncertainty.

In such cases, a 'break even analysis' can be useful. This is based on estimating the costs of the regulation and then asking, 'how effective must the regulation be for the benefits to be seen as justifying the costs?' Judgements can then be made by policy makers as to whether the regulations are, in fact, expected to have this degree of effectiveness.[44]

Cost-effectiveness analysis

Cost-effectiveness analysis (CEA) involves comparing a range of policy options in terms of the respective costs of achieving given an outcome (or benefit).[45]

CEA is a more limited methodology than CBA and is less demanding of resources and expertise to complete.[46]

This analysis is a widely used alternative to CBA in circumstances where policy officers are unable to monetise the most important policy impact.[47]

It essentially takes the benefits of regulation as given and asks the question: 'which of the possible ways of achieving the regulatory objective has the lowest cost?' The lowest cost option is said to be the most'cost-effective'. It can also be regarded as being the most efficient option.[48]

Multi-Criteria Analysis

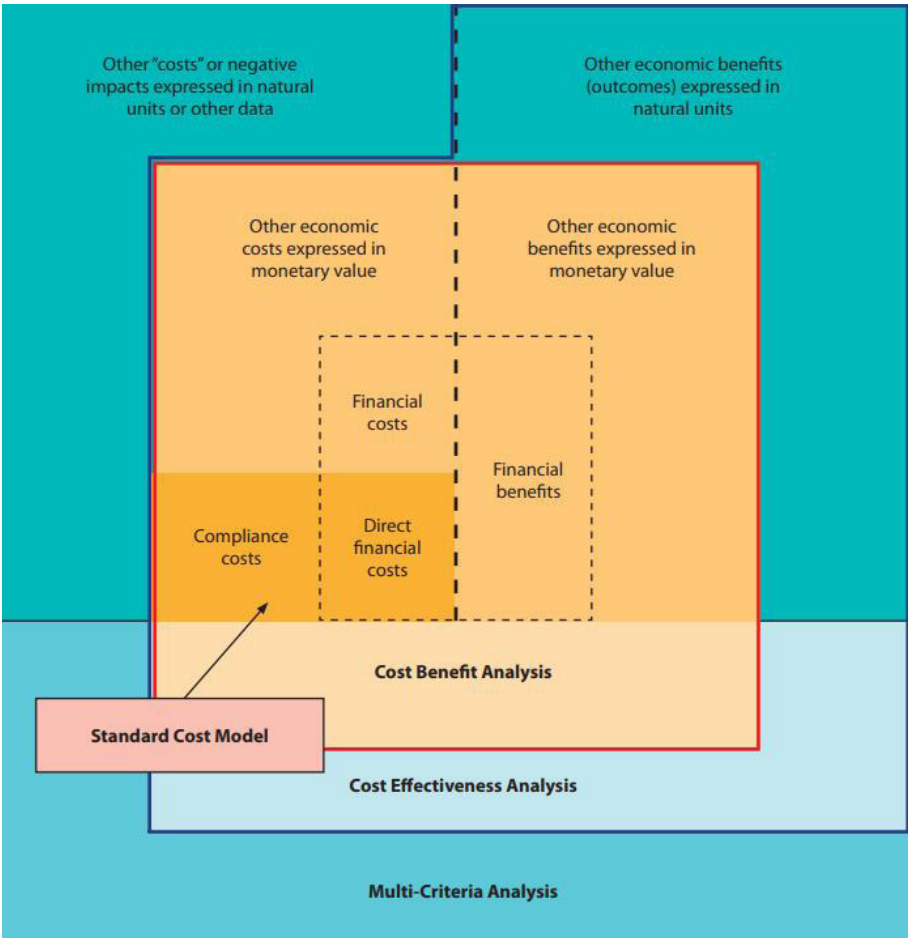
This is useful when options must be ranked according to different criteria.[49]

Multi-Criteria Analysis (MCA) is a methodology that allows systematic and transparent decisions to be made even where quantification of major regulatory impacts is not possible.

MCA involves identifying the underlying policy objectives and then determining all of the factors (the criteria) that would indicate achievement of these objectives.[50]

Methods in one picture

Taking into account the fact that impacts as well as methods for assessing them can be very different in their nature, as well as in their level of importance, it is necessary to understand how different types of impacts and methods can relate to each other in a 'common picture.' The picture [51] below offers a visualisation of how benefits and costs link to each other.



Ex-post RIA[52]

Cross-country experiences over the last several decades have led to a closer integration of (*ex-post*) evaluation with (*ex-ante*) RIA. After all, RIAs are contingent on hypotheses about how an intervention will produce effects. It is necessary to test these hypotheses against real-world facts, controlling for the unintended consequences of the intervention.[53]

The approaches employed for reviews of regulations, like regulations themselves, need to be fit for purpose. The broad approaches to review are generally classified according to different points in time; whereas the various tools or methodologies employed, whilst individually distinct, may share some characteristics both within and across review approaches. In this manner we will mention some examples such as programmed reviews, *ad hoc* reviews and ongoing stock management.[54]

The timing, scope, and review methodologies of the three approaches will likely change across review types, as well as within them.

Given the different focusses of these reviews, it may also be the case that they adopt different review methodologies. In consequence, a certain amount of overlap may be present between the types of reviews, their timing and scope, and the methodologies selected.

As we have said above, *ex-post* evaluation can entail a wide range of criteria and methodological approaches. However, some common features to be considered in an evaluation framework can be identified.

As regards relevance, we may ask: Do the policy goals cover the key problems at hand?

In relation to Effectiveness: Was the policy effective in achieving the intended outcomes? Have there been negative effects?

About efficiency: Is the regulation the most cost-effective solution to a given issue? Have there been any unintended consequences?

With respect to alternatives: What are the potential alternatives to the regulation, including non-regulatory options?

Finally, in terms of coherence: Is the regulation coherent with existing regulations?[55]

We consider that RIA can help analyse many of these features.

In order to effectively review and provide recommendations to improve existing laws, it is important to determine if the regulatory framework achieved its desired objectives, if the law was implemented efficiently and effectively, and to what extent any (unexpected) impacts of the regulatory intervention were properly addressed

Ideally, *ex-post* assessments of regulatory performance should have symmetry with *ex-ante* assessments: through verifying that stated objectives have actually been met, determining whether there have been any unforeseen or unintended consequences, and considering whether alternative approaches could have done better. Unluckily, this does not seem to be the case of the IBC.[56]

For example, in Mexico, *Comisión Nacional de Mejora Regulatoria* /National Commission for Regulatory Improvement (CONAMER) requires that public agencies from the public administration submit an *ex-post* evaluation of the regulation they issue. Based on the nature and type of the regulation, the procedures that must be followed by the agencies may differ somewhat. The RIA questionnaire however includes objectives of the regulation; initial problem and its status; updated statistics; feasible alternatives to the regulation; impact assessment; cost-benefit analysis; public consultation; and improvement opportunities.[57]

The exercises of *ex-post* evaluations expressed above are in fact instruments or mechanisms to induce an assessment. For example, *sunsetting clauses* and *one-in, x-out* rules are legal devices, which call for an assessment in order to comply optimally and effectively with the request.

However, the implementation of a specific methodology to evaluate the impact of a regulation may depend on several factors: a) The width of the regulation; a law amendment, a new law, a set of laws; b) the age of the regulation; c) the capacity to observe a control situation or a base line scenario; d) data availability;[58] e) the characteristics and access to the beneficiaries and affected parties: f) resources to conduct methodologies; g) the balance between the cost of the evaluation vs. the potential impacts, the population target, the empirical evidence of causality.[59]

In our view, the evaluation of existing policies through *ex post* impact analysis is necessary to ensure that regulations are effective and efficient.[60] Also, we think that RIA may have some advantages over other methods.

For example, one way to proceed with an assessment is to comply with the best international practices. International standards reflect best practices endorsed by the international community and are used for qualitative assessments. Standards represent the consensus of international bodies on the core features of legal or regulatory systems.[61] In this case, India has exhibited significant progress in the implementation of the International Organisation of Securities Commissions Principles for the financial sector *vis-á-vis* the assessment concluded in 2000.[62]

In the area of insolvency, the international standard is composed of the recommendations included in the UNCITRAL Legislative Guide on Insolvency Law and the World Bank Principles on Effective Insolvency and Creditor Rights Systems. Assessments of compliance with the international standard can be conducted on a stand-alone basis (Insolvency and Creditor Rights ROSCs) or as part of a general assessment of the financial sector (FSAP).[63]

But the comparison or check list with best practices may not take into account the cost of implementation (and compliance) and we must be careful with transplantation of norms.[64]

While the objectives of insolvency regimes are well-established, there is less consensus on their optimal design. Given the complementarities between insolvency regimes and other institutional settings, such as enforcement quality and judicial efficiency, there is no 'one size fits all' approach.[65]

And although the same caveat must be brought about the utilisation of RIA,[66] we think that this method has the potential for better adaption to the particular characteristics of a country.

Also, another quantitative method [67] is through 'scorecards.' They provide measures of the overall impact of different regulations, relying on economic performance indicators such as costs, benefits, lives or life-years saved, cost-effectiveness, but – it has been argued - disregard un-quantified costs and benefits, neglect distributive impacts and do not disclose the true level of uncertainty.[68]

An examination of RIA practices within OECD jurisdictions indicates that the adoption of RIA is now widespread, but its design and application vary significantly.[69] But even if RIA can be adapted to specific conditions, there are some common issues to consider: the level of political commitment needed to introduce RIA, the constitution of a team inside the administration looking at the particularities of the institutional setting and the way RIA can make a difference in the decision-making process (if integrated as early as possible).[70]

RIA AND IBC

One critical issue for assessment is to work on concept formation before we move on to measurement.[71] We believe that in the case of the IBC this task has been achieved so the assessment becomes the next logical step.

In this line of thought, obtaining high quality data is a basic challenge for RIA. Without good data, RIA will contribute relatively little to good policy-making. But data collection can be a time-consuming and expensive exercise. This means that we must adopt a careful and strategic approach to data collection.[72]

Moreover, an analysis based on empirical data is invaluable in the design of insolvency reforms.[73] About this issue, we cannot stress enough the impressive work of the IBBI's working group.[74]

Data quality, an essential element of proper analysis, has been recognised as one of the most difficult parts of RIA because it can be time and resource consuming and requires a systematic and functional approach that is not used by many governments. The usefulness of RIA depends on the quality of the data used to evaluate the impact of a proposed or existing regulation. A poor data collection strategy can mean that the essential data to conduct good analysis is lacking.[75]

And a great challenge is the marked lack of available data for developing countries with which to assess potential impacts. Even when data is available in certain parts of the government or the private sector, it can be difficult to acquire due to a reluctance to share information. This culture of secrecy is often compounded by limited technical capacity to employ analytical tools and particularly economic analysis such as CBA, which at times has become unwieldy.[76]

In the same way, we may add that the data may result to be a critical barrier. Those countries who have tried to do *ex post* studies of regulatory outcomes quickly run into numerous data problems. In addition, there are often problems just finding out what the outcomes were.[77]

In summary, we can say that data gathering represents a fundamental step towards the assessment and design of any insolvency regime. Hard data is essential for evidence-based policy-making as RIA. Relevant data provides the empirical foundation for the identification of issues and subsequently, formulation of changes to the law.

However, data by themselves are just isolated pieces of information, data only have value within a conceptual framework. Data collection and statistics support analytical work, rather than replacing it. Any attempt to measure inherently qualitative concepts in numeric terms is challenging. Extensive data collection requires reliable mechanisms that can be costly, but even the best statistical results have interpretative limits. Data and statistics cannot offer details about the context, history, externalities or country-specific circumstances.[78] With respect to insolvency, the concepts of effectiveness and efficiency help to define the scope of data collection.[79]

The propositions already made by the IBBI Working Group are a vital step and detail planning to obtain and analysed the so much needed data for any assessment.

From there, the path may be easier. It has been suggested that the drafting of RIA of existing regulations is easier than RIA of new regulations because regulators already have data to be used for it. And although RIA is not usually required for reviewing the current regulatory corpus, many countries seem to require RIA in this case.[80]

Regarding the measurement, IBBI's Working Group has made a very detail plan for data collection with the specific method to analyse it. In this matter, direct outcomes of the IBC such as improvement in realisations by creditors, timely resolution of the corporate debtors and decrease in insolvency resolution process cost are clearly visible and have been acknowledged by different reports and institutions. Certain outcomes that are qualitative in nature have also started panning out. One of the most visible qualitative outcomes that the Code has brought about is the behavioural change in creditors and debtors.[81]

CONCLUSION

RIA clearly complements current regulatory and decision-making frameworks to make them more efficient and transparent, while at the same time increasing regulators' accountability.[82]

A well-functioning RIA system can assist in promoting policy coherence by making transparent the trade-offs inherent in regulatory proposals, identifying who is likely to benefit from the distribution of impacts of regulation.[83]

However, impact assessments are still rare in insolvency reform.[84] Impact assessments remain at a rather infant stage in insolvency reforms, primarily due to the lack of relevant hard data. As a result, they have relied on available indicators or surveys.[85]

Integration with other policy instruments and institutional design is of great importance. RIAs are more effective if combined with policy evaluation, risk management, freedom of information and general principles of transparency and access to information held by public bodies. It is the overall ecology of procedures for appraising policy options that makes the difference. As for governance, RIA requires political commitment, training, up-to-date guidance material and oversight mechanisms.[86]

We share the idea that RIA should not be regarded as an exact science that can be replicated in different contexts if the 'correct' steps are followed.[87]

RIA efforts must be scaled to the specific capacities of a country, especially given the often low government resources to collect and analyse required data. This, however, does not mean that RIA efforts would be futile in developing countries, rather the contrary since RIA is more about the process of asking the right questions to the right people (and thus creating a framework for regulatory policy making) than about technically precise impacts statements.[88]

Rather, we argue that RIA can be seen as a set of guiding principles that are ultimately intended to improve outcomes in terms of decision-making.[89]

RIA is a tool that can be used for reviewing existing regulation, as well as for assessing impacts of proposed amendments. This is particularly relevant for developing countries where the stock of regulations may have pervasive effects.[90] The failure to conduct RIA while developing regulations, which is often the case in developing countries, should not deter a RIA for review of existing regulations. Principles of RIA can be very helpful in conducting evaluation of existing regulations and correcting the errors in place. Thus, RIA can be of great assistance for these countries.[91]

RIA is nowadays widely adopted but practiced differently. We don't find many reasons not to adapt or integrate the RIA methodology to the analysis and take the IBBI's Working Group paper as a cornerstone for the assessment.

For many countries, and for a number of different policy areas, the implementation of RIA remains work in progress. In this respect the integration of RIA should be seen as a long-term policy goal.[92] It is therefore important to acknowledge specificities and particularities when reflecting on the way RIA could be introduced and implemented.[93]

Also, learning processes are fundamental in impact assessment systems. RIA needs time, and there is nothing wrong in starting from limited objectives and then learn by doing.[94]

Finally, we can warn that the voyage is also likely to be a lengthy one: experience of RIA in OECD countries demonstrates that RIA systems are dynamic and undergo many years, of revision and improvement. In that sense, those willing to implement RIA in developing countries can expect a similarly enduring ride.[95]

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38 Supra Note 30, "Other methodologies include comparing positive and negative impacts, qualitative and quantitative methods, multi-criteria analysis, partial and general equilibrium analysis, as well as assessing direct and indirect effects. The RIA methodology must first suit the objective of RIA as well as the administrative context and capacity".
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Quantity = - the size of the population of businesses affected (number of businesses affected) and;
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67 Supra Note 8, "Qualitative methods are based on inductive logic – they aim to arrive at statements, assumptions or hypotheses based on empirical observation or data. Quantitative methods, on the other hand, are based on deductive logic – they aim to verify if a certain statement, assumption (a hypothesis) holds true in the real life and according to empirical data. To sum up, quantitative methods are used for verifying hypotheses, but qualitative methods – to create them".
68 *Íbid*, p. 291.
69 Supra Note 19
70 Supra Note 34
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72 Supra Note 44
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74 Supra Note 10
75 Supra Note 34
76 Supra Note 23
77 Supra Note 21
78 Supra Note 58
79 *Íbid*, p. 4.
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92 Supra Note 19
93 Supra Note 34
94 Supra Note 20
95 Supra Note 23

20

DOES INSOLVENCY AND BANKRUPTCY CODE IMPROVE CREDIT CHANNELS FOR FIRMS IN INDIAN MANUFACTURING SECTOR?

— Kanwaljeet Singh, Rajdeep Singh and Yadwinder Singh

Executive Summary

An effective credit ecosystem is vital for the growth of the capital markets and the economy of the country through increased entrepreneurial activities. The current research examined the impact of the Insolvency and Bankruptcy Code, 2016 (IBC / Code) on credit channels and performance of firms in Indian manufacturing sector. In this regard, the researchers employed Difference-in-Differences (DiD) methodology and found that post IBC, the credit channels and performance of firms for distressed firms improved more as compared to non-distressed firms. This could happen only because of increased credit supply post greater creditor protection. Further, it gives important insights with regards to the role played by credit channels in improving the performance of resource crunched financially distressed firms.

Keywords: Insolvency and Bankruptcy, Impact, Credit Channels, Manufacturing Sector.

INTRODUCTION

An effective credit ecosystem is vital for the growth of the capital markets and the economy of the country through increased entrepreneurial activities.[1] A sound bankruptcy process that aims at balancing the rights of the debtors and creditors propels enhanced risk-taking, improves credit market access, and fuels economic growth. The enactment of the Code in 2016 has consolidated the various fragmented laws dealing with insolvency and bankruptcy in India and has become unified law for resolving insolvencies in the country.[2] Post the application of the IBC, the recovery rates have reached 42.5% whereas it was only 14.5% during the period of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act) (Economic Survey, 2020). Further the duration of the resolution process has declined from 4.3 years in the pre-IBC period to an average of 340 days in the post IBC period. Insolvency reforms strengthen creditors rights and result in greater issuance of long-term debt.[3] In the proposed study, the researchers are interested in scrutinising the causal impact of the IBC on demand and access to credit by distressed and non-distressed firms in the Indian manufacturing sector. 'Credit channels' refers to enhanced availability of funds (both long term and short term) and reduced cost of financing due to effective credit recovery mechanisms and greater creditor's protection under the IBC.[4] To add on, the researchers will also examine if credit channels are acting as efficient transmission mechanisms in leveraging the impact of the IBC on the performance of the firms in the manufacturing sector.

The proposed study will contribute to the literature in multitude ways. Firstly, to the best of our knowledge, it will be one of the pioneer studies that examines the causal impact of the IBC on credit channels of both distressed and non-distressed firms in the Indian manufacturing sector. Most of the earlier studies on impact of the IBC have not touched upon this aspect. In this regard, the econometric methodology employed and the results from the study would be immensely important and applicable to other emerging economies which are relatively at the same level on the economic growth ladder. Secondly, it will give important insights with regards to the role played by credit channels in improving the performance of resource crunched financially distressed firms. In this context, the researchers will evaluate if credit channels act as efficient transmission mechanisms of the IBC and can improve the performance of distressed Indian manufacturing firms. Thirdly, the findings of the study give important insights for policy makers to comprehend the effectiveness of the IBC in improvising credit channels. Further, it will also act as a reference for other researchers who wish to evaluate the efficiency and effectiveness of the IBC in general.

The rest of the paper is organised as – First it gives a brief theoretical background for the study followed by research methodology. It then presents the empirical results and the conclusion of the paper.

THEORETICAL BACKGROUND

Notwithstanding a substantial body of literature exists that investigates the effect of enhanced creditor's rights on economic and financial development in general and on credit conditions.[5] An effective insolvency law aims at ensuring that the financially distressed firms can continue their businesses by reorganising themselves.[6] It has been highlighted that greater creditor rights stimulated the development of credit markets as it was found that greater creditor rights were associated with enhancement of higher proportion of private credit to gross domestic product.[7] To add on, in a research study on impact of bankruptcy and insolvency reforms across 11 economies observed that these reforms led to enhancement of creditor's rights and consequentially led to increased supply of long-term debt.[8] There has been other research that are in line with the above findings that bankruptcy reforms have led to greater credit availability at a lower cost to the firms as result of greater creditor protection.[9] It has also been seen that the level of enforcement costs for the lenders has an influence on the firm's debt maturity choice. It has been pointed out that reduction in the enforcement costs results in shift of focus towards long term debt as a source of financing.[10] Thus, in an environment where enforcement costs of contracts are low, the firms will drift away from short term financing towards development focused long term financing. These findings are in line with a study conducted where the researcher found that enhanced and stronger rights of the creditors result in higher leverage, lower cost of financing and increased availability of credit.[11]

To add on, it has been seen that enhanced credit channels in the form of greater availability of credit and reduced financing cost result in a significant improvement on the performance of the firms. It has been highlighted that the insolvency and bankruptcy law facilitates the financially weak firms to reestablish themselves by investing in activities that generate value for them.[12] These findings were later validated and it was found that bankruptcy law exerts a positive influence on the performance of financially distressed companies. In the light of above discussion, the researchers are of the opinion that there is a dire need to examine the impact of the IBC on credit channels in Indian manufacturing sector and the impact of these credit channels on performance of financially distressed firms.[13]

RESEARCH METHODOLOGY

The research design for the study is descriptive and analytical in nature. The study attempts to analyse the impact of the IBC on the credit channels of distressed and non-distressed firms in the Indian manufacturing sector. Also, the researchers examined the impact of the IBC on the performance of the distressed firms in the sector through these credit channels. In this light, the researchers examined if credit channels can improve the performance of distressed Indian manufacturing firms by acting as efficient transmission mechanisms of the IBC policy.

Data

The sample for this study comprised of a panel dataset comprising of all manufacturing firms in India from the year 2011 to 2021. The financial data of firms in the manufacturing sector was collected from capitaline database. Initially there were 16,984 manufacturing firms which comprised our sample. However, only firms which were incorporated before 2011 and had atleast three consecutive years of time series observation and were consistently in operation during the study period comprised the final sample. To control for the measurement errors and to avoid the impact of possible spurious outliers on our findings, the variables used in the models were winsorized at 1% level.

Post the removal of few firms the final sample comprised of 13,567 manufacturing firms.

Description of Variables

The notion credit channels in this research study refers to the enhanced availability of financing (Total Credit) and the decline in the credit cost due to better mechanisms in the IBC for faster and efficient recovery. [14] The researcher will use two different models. In the first model credit channels will be the dependent variable and in the second model return on assets (ROA) will be the dependent variable. A summarised description of all the variables is given in Table 1.

Table 1: Summarised Description of Variables

Classification	Variable	Operationalisation
Credit Channels	Total Credit	Total Debt (TD)/ Total Assets (TA)
	Cost of Debt	Total Interest Expenses (TIE) /Total Debt (TD)
Performance Measures	Return on Assets	Net Income (NI) / Total Assets (TA)
IBC Framework	IBC (Dummy)	= 1 if the observation occurs in the post IBC period (2016-2021) = 0 otherwise.
Distressed Firm	Distress (Dummy)	= 1 if a firm in a year has accumulated losses equal to or exceeding 50% of its average net worth in the immediately preceding four financial years = 0 otherwise.
Size	Size of Firm	Log (Total Assets)
Liquidity	Liquidity of firm	Net Working Capital/ Total Assets
Age	Age of Firm	Log (No. of years since incorporation)
Collateral	Security for Credit	Net Fixed Assets / Total Assets

Empirical Model

To examine the empirical analysis of impact of the IBC on credit channels of distressed firms and non-distressed firms and role of the IBC in improving the performance of distressed firms in the post the IBC period through these credit channels the researchers have used a quasi- experimental approach named DiD to evaluate the impact of the IBC framework. The researchers compared the variations in credit channels and the performance of the firms over time between the distressed (treatment group) and non-distressed firms (control group). The reliability and the accuracy of the results of this technique are dependent upon parallel trend assumption which can be verified using graphical plots and placebo test. In order to evaluate the impact of the IBC on credit channels and performance of distressed and non-distressed firms in the Indian manufacturing sector over the period 2011-2021, the researchers have formulated and tested different models discussed below.

Impact of the Code on credit channels of firms

The researchers have used the DiD approach to scrutinise the impact of the IBC on the total credit and the cost of borrowing for the distressed firms. In line with[15] the researchers measured the debt structure by taking the ratio of total debt to total assets and measured the cost of borrowing by taking the ratio of total interest expense to total debt. To test the impact of the IBC on credit channels of firms over the period from 2011-2021, the researchers estimate two separate regression models given below:

$$\boldsymbol{TD/TA_{it} = a_0 + a_1 IBC_t * Distress_{it} + a_2 Distress_{it} + a_3 size_{it-1} + a_4 liquidity_{it-1}}$$
$$\boldsymbol{+ a_5 age_{it-1} + a_6 collateral_{it-1} + \gamma_i + \theta_t + \varepsilon_{it}} \ldots\ldots\ldots\ldots\ldots\ldots\text{Eq(1)}$$

Where TD/TA is Total Debt to Total Assets and is a measure of Credit Channel, the IBC is a dummy variable which takes value 1 if the observation occurs in the post IBC period (2016-2021) and 0 otherwise. Distress is a dummy which takes value 1 if a firm in a year has accumulated losses equal to or exceeding 50% of its average net worth in the immediately preceding four financial years and 0 otherwise. IBC*Distress is the interaction term and a_1 is our coefficient of interest. Size, liquidity, age and collateral are firm level control variables introduced with 1 time period lag in the model. $\gamma_i, \theta_t, \varepsilon_{it}$ in the above model are firm fixed effects, time fixed effects and random error term respectively.

$$\boldsymbol{TIE/TD_{it} = a_0 + a_1 IBC * Distress + a_2 Distress_{it} + a_3 size_{it-1} + a_4 liquidity_{it-1} +}$$
$$\boldsymbol{a_5 age_{it-1} + a_6 collateral_{it-1} + \gamma_i + \theta_t + \varepsilon_{it}} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\text{Eq(2)}$$

Where TIE/TD is Total interest expense to Total Debt and is a measure of Credit Channel, IBC is a dummy variable which takes value 1 if the observation occurs in the post IBC period (2016-2021) and 0 otherwise. Distress is a dummy which takes value 1 if a firm in a year has accumulated losses equal to or exceeding 50% of its average net worth in the immediately preceding four financial years and 0 otherwise. IBC*Distress is the interaction term and a_1 is our coefficient of interest. Size, liquidity, age and collateral are firm level control variables introduced with 1 time period lag in the model. $\gamma_i, \theta_t, \varepsilon_{it}$ in the above model are firm fixed effects, time fixed effects and random error term respectively.

In the above two models, the firm level fixed effects have been introduced so as to control for any unobserved heterogeneity that may exist amongst the firms in the sample. Also, the researchers have introduced time fixed effects in the model so as to control for any other macroeconomic shocks that may have had an influence on the demand for credit and the cost of borrowing. In both the above equations 1 and 2, the main variable of interest is the coefficient of double interaction term of $IBC_t * Distress_{it}$. Firm level control variables size, liquidity, age and collateral are introduced with 1 time period lag in the model so as to address the possible simultaneity problem.

Impact of the Code on performance of firms through credit channels.

To evaluate the impact of the IBC on performance of the distressed and non-distressed firms through credit channels over the period from 2011-2021, the researchers used DiD approach and estimated two separate regression models given below:

$$ROA_{it} = a_0 + a_1 IBC_t * Distress_{it} * \widehat{TD/TA}_{it-1} + a_2 Distress_{it} * \widehat{TD/TA}_{it-1} + a_3 IBC_t *$$
$$\widehat{TD/TA}_{it-1} + a_4 IBC_t * Distress_{it} + a_5 \widehat{TD/TA}_{it-1} + a_6 Distress_{it} + a_7 size_{it-1} +$$
$$a_8 liquidity_{it-1} + a_9 age_{it-1} + a_{10} collateral_{it-1} + \gamma_i + \theta_t + \varepsilon_{it} \ldots\ldots\ldots\ldots\text{Eq(3)}$$

Where ROA is the return on assets of firms and is a performance measure. $\widehat{TD/TA}_{it-1}$ is the first lag of predicted Total Debt to Total Assets and is a measure of Credit Channel, IBC is a dummy variable which takes value 1 if the observation occurs in the post IBC period (2016-2021) and 0 otherwise. Distress is a dummy which takes value 1 if a firm in a year has accumulated losses equal to or exceeding 50% of its average net worth in the immediately preceding four financial years and 0 otherwise. IBC *Distress is the interaction term and a_1 is our coefficient of interest. Size, liquidity, age and collateral are firm level control variables introduced with 1 time period lag in the model. $\gamma_i, \theta_t, \varepsilon_{it}$, in the above model are firm fixed effects, time fixed effects and random error term respectively. $IBC_t * Distress_{it} *$

$\widehat{TD/TA}_{it-1}$,$Distress_{it} * \widehat{TD/TA}_{it-1}$, $IBC_t * \widehat{TD/TA}_{it-1}$ and IBC_t* $Distress_{it}$ are the interaction variables.

$$ROA_{it} = a_0 + a_1 IBC_t * Distress_{it} * \widehat{TIE/TD}_{it-1} + a_2 Distress_{it} * \widehat{TIE/TD}_{it-1} + a_3 IBC_t * \widehat{TIE/TD}_{it-1} + a_4 IBC_t * Distress_{it} + a_5 \widehat{TIE/TD}_{it-1} + a_6 Distress_{it} + a_7 size_{it-1} + a_8 liquidity_{it-1} + a_9 age_{it-1} + a_{10} collateral_{it-1} + \gamma_i + \theta_t + \varepsilon_{it} \text{..............Eq(4)}$$

Where ROA is the return on assets of firms and is a performance measure. $\widehat{TIE/TD}_{it-1}$ is the first lag of predicted Total interest expense to Total Debt and is a measure of Credit Channel, IBC is a dummy variable which takes value 1 if the observation occurs in the post IBC period (2016-2021) and 0 otherwise. Distress is a dummy which takes value 1 if a firm in a year has accumulated losses equal to or exceeding 50% of its average net worth in the immediately preceding four financial years and 0 otherwise. IBC*Distress is the interaction term and is our coefficient of interest. Size, liquidity, age and collateral are firm level control variables introduced with 1 time period lag in the model. $\gamma_i, \theta_t, \varepsilon_{it}$ in the above model are firm fixed effects, time fixed effects and random error term respectively. $IBC_t * Distress_{it} * \widehat{TIE/TD}_{it-1}$,$Distress_{it} * \widehat{TIE/TD}_{it-1}$, $IBC_t * \widehat{TIE/TD}_{it-1}$ and $IBC_t * Distress_{it}$ are the interaction variables.

In the above two models, the firm level fixed effects have been introduced so as to control for any unobserved heterogeneity that may exist amongst the firms in the sample. Also, the researchers have introduced time fixed effects in the model so as to control for any other macroeconomic shocks that may have had an influence on the performance of the firms. Following Bose et al. (2021),[16] the researchers have taken predicted values of $\widehat{TD/TA}_{it-1}$ and $\widehat{TIE/TD}_{it-1}$ so as to take care of the generated regression problem. In both the above equations 1 and 2, the main variable of interest is the coefficient of triple interaction term of $IBC_t * Distress_{it} * \widehat{TD/TA}_{it-1}$ and $IBC_t * Distress_{it} * \widehat{TIE/TD}_{it-1}$ that takes into consideration whether the distressed firms are able to improve their performance with increased financing and reduced cost of borrowing viz. a viz. the non-distressed firms. Firm level control variables size, liquidity, age and collateral are introduced with 1 time period lag in the model so as to address the possible simultaneity problem.

EMPIRICAL RESULTS

This section gives an account of the descriptive statistics and results of the model estimation.

Impact of the Code on credit channels of firms

This section reports the results of the DiD estimation to study the influence of the IBC on credit channels. The researchers have used total debt to total assets and cost of borrowing as the proxies for credit channels. The results of the DiD estimation are presented in Table 2. Column 1 of table 2 provides the results for the ratios of total debt to total assets while column 2 gives the results for cost of borrowing as the dependent variable. Distress_IBC captures the impact of policy change on credit channels of distressed firms (treatment group) *vis-à-vis*. the non-distressed firms (control group). The coefficient of Distress_IBC is of interest to us. The coefficient of Distress_IBC is significant at 1% level of significance in both the columns indicating that there is a positive impact of the IBC policy implementation on total credit which is more favourable for distressed firms as compared to their non-distressed competitors. Post the introduction of the IBC, the access to total credit increased by 4.9%and the cost of borrowing has come down by 1.6% for distressed firms as compared to non-distressed firms.

Table 2: Impact of IBC on Credit Channels

Dependent Variable =	(1) TD/TA	(2) Cost of Borrowing
Distress_IBC	0.049***	- 0.016***
	(1.14)	(-1.15)
Distress	0.031***	0.036
	(2.72)	(0.12)
age_L1	0.045***	-0.112*
	(3.96)	(-1.19)
size_L1	0.124*	-0.015***
	(4.46)	(-2.14)
collateral_L1	0.117**	-0.019**
	(1.271)	(-1.77)
liquidity_L1	0.028**	-0.016
	(2.761)	(-1.01)
Constant	0.014***	0.019***
	(.089)	(1.14)
Observations	81,349	81,180
R-squared	0.058	0.021
Firm Fe	Yes	Yes
Time FE	Yes	Yes

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$

Further, there is a significant positive impact of distress on the total credit. The positive impact can be attributed to the need of distressed firms to raise more funds to cover up the losses. Also, there is a significant influence of age, size, collateral and liquidity on the demand for total credit and significant influence of age, size and collateral on cost of borrowing of the firms.

Impact of the Code on performance of firms through credit channels

This section reports the results of the DiD estimation to study the influence of the IBC on performance of firms through credit channels. The researchers have used total debt to total assets and cost of borrowing as the proxies for credit channels and return on assets as a proxy to measure firm performance. The results of the DiD estimation are presented in Table 3 and Table 4. Table 3 gives the results of impact of the IBC on performance through credit channel when total debt to total assets is used as a proxy for credit channel.

Table 3: Impact of the IBC on Performance through credit channels

(CC = TD/TA)

Dependent Variables	(1) ROA
Distress*IBC*$\widehat{TD/TA}_{it-1}$	0.078**
	(2.35)
IBC*$\widehat{TD/TA}_{it-1}$	0.084***
	(1.41)
Distress*$\widehat{TD/TA}_{it-1}$	-0.065**
	(-3.12)
Distress*IBC	0.191*
	(1.39)
$\widehat{TD/TA}_{it-1}$	0.039
	(1.06)
Distress	-0.134***
	(-1.87)
age_L1	-0.058***
	(-2.65)
size_L1	0.021***
	(1.04)
collateral_L1	0.067*
	(1.27)
liquidity_L1	0.288
	(02.95)
Constant	0.007*
	(0.154)
Observations	80,184
R-squared	0.045
Firm Fe	Yes
Time FE	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

The main variable of interest is the coefficient of triple interaction term of $IBC_t * Distress_{it} * \widehat{TD/TA}_{it-1}$ that takes into consideration whether the distressed firms are able to improve their performance with increased financing *vis-à-vis* non-distressed firm. Coefficient of Distress*IBC*$\widehat{TD/TA}_{it-1}$ is significant at 5% which implies that distressed firms are able to improve their performance with availability of increased credit *vis-à-vis* their non-distressed counterparts. All the variables in the DiD model are statistically significant except liquidity.

Further, Table 4 gives the results of impact of the IBC on performance through credit channel when cost of borrowing is used as a proxy for credit channel.

Table 4: Impact of the Code on performance of firms through credit channels

(CC = Cost of Borrowing)

Variables	(1) ROA
Distress*IBC*$\widehat{TIE/TD}_{it-1}$	-0.018*** (-2.76)
IBC*$\widehat{TIE/TD}_{it-1}$	-0.138*** (-3.69)
Distress*$\widehat{TIE/TD}_{it-1}$	-0.394*** (-3.42)
Distress*IBC	-0.149 (1.51)
$\widehat{TIE/TD}_{it-1}$	0.016 (0.38)
Distress	-0.311*** (-3.37)
age_L1	-0.283** (2.64)
size_L1	0.029** (2.47)
collateral_L1	0.237*** (2.27)
liquidity_L1	0.045 (1.31)

Variables	(1) ROA
Constant	0.226
	(0.473)
Observations	81,180
R-squared	0.021
Firm Fe	Yes
Time FE	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

The main variable of interest is the coefficient of triple interaction term of Distress*IBC*$\widehat{TIE/TD}_{it-1}$ that takes into consideration whether the distressed firms are able to improve their performance with decreased cost of financing *vis-à-vis* non-distressed firm. Coefficient of Distress*IBC*$\widehat{TIE/TD}_{it-1}$ is significant at 1% which implies that distressed firms are able to improve their performance with availability of increased credit *vis-à-vis* their non-distressed counterparts. All the firm level variables in the model are significant except liquidity.

Robustness Check

This section presents the results of Placebo tests for the pre-policy period of 2011 to 2015. This placebo tests checks for the validity of our estimated results. Instead of the reform taking place in 2016, the researchers assume that the IBC was introduced in 2013 and run the DiD estimation. This Placebo test helps if any other policy interventions or macroeconomic changes are influencing the credit channels or performance of the firms. The results of placebo test in Tables 5,6 and 7 highlight that there is no significant impact of the IBC on total debt or cost of borrowing of distressed firms. Further, there is no significant influence of the IBC on performance of firms through credit channels. Therefore, the placebo tests results validate our main findings.

Table 5: Impact of the IBC on credit channel (2011-2015) (Supposed the IBC implemented in 2013)

VARIABLES	(1) TD/TA	(2) Cost of Borrowing
Distress_IBC	0.025	-0.017
	(1.39)	(-0.09)
Distress	0.224	0.148*
	(2.16)	(1.16)
Size_L1	0.011	-0.039
	(1.91)	(-0.18)

VARIABLES	(1) TD/TA	(2) Cost of Borrowing
Age_L1	0.102*	0.144
	(1.70)	(2.25)
Collateral_L1	0.659	0.092
	(4.58)	(3.23)
Liquidity_L1	0.068	0.342
	(1.13)	(2.21)
Constant	0.112	0.168
	(1.12)	(1.01)
Observations	43,502	43,382
R-squared	0.058	0.020
Firm Fe	Yes	Yes
Time FE	Yes	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 6: Impact of the IBC on performance (2011-2015) (Supposed the IBC implemented in 2013 (CC=TD/TA)

VARIABLES	(1) ROA
IBC*Distress*$\widehat{TD/TA}_{it-1}$	-0.011 (-0.26)
Observations	42,686
R-squared	0.003
Firm Fe	Yes
Time FE	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 7: Impact of IBC on performance (2011-2015) (Supposed IBC implemented in 2013 (CC=cost of borrowing)

VARIABLES	(1) ROA
IBC*Distress*$\widehat{TIE/TD}_{it-1}$	-0.038 (-0.43)
Observations	42,686
R-squared	0.014
Firm Fe	Yes
Time FE	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

CONCLUSION

The enactment of the IBC in 2016 has consolidated the various fragmented laws dealing with insolvency and bankruptcy in India and has become unified law for resolving insolvencies in the country.[17] Post the application of the IBC the recovery rates have reached 42.5% whereas it was only 14.5% during the period of SARFAESI Act (Economic Survey, 2020). The current research examined the impact of the IBC on credit channels and performance of firms in Indian manufacturing sector. Most of the earlier studies on impact of the IBC have not touched upon this aspect. In this regard, the researchers employed DiD and found that post IBC, the credit channels and performance of firms for distressed firms improved more as compared to non-distressed firms. This could happen only because of increased credit supply post greater creditor protection. The results from the study are immensely important and applicable to other emerging economies which are relatively at the same level on the economic growth ladder. Further, it gives important insights with regards to the role played by credit channels in improving the performance of resource crunched financially distressed firms. The findings of the study give important insights for policy makers to comprehend the effectiveness of the IBC in improvising credit channels in other sectors also. Further, it will also act as a reference for other researchers who wish to evaluate the efficiency and effectiveness of the IBC in general.

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21

GREEN INSOLVENCY:

PERSPECTIVE AND POLICY PRESCRIPTION

— *Namrata Nair and Medha Shekar*

Executive Summary

The study conducts a meta-analysis of the literature on climate change and its interaction with insolvency regimes across the world and in India. It develops a case for the need for a climate-sensitive insolvency regime in India. The world's first climate change-induced bankruptcy of the Pacific Gas and Electric (PG&E) is testimony to the fact that climate change-induced insolvencies are no longer a challenge of the future. Macro-prudential and regulatory policy coherence is required to address the physical and transitional risks presented by climate change. Several sectors such as those that run heavily on fossil fuels are located in vulnerable geographical locations and are at greater risk of insolvency due to climate change. Increased compliance costs based on the Environmental, Social, and Corporate Governance principles (ESG principles) and rising environmental liabilities of firms also signal the need for tandem between insolvency and bankruptcy laws and environmental laws. This study collates cross-country evidence on the treatment of environmental claims and the incorporation of climate-sensitive policies in insolvency regimes in different jurisdictions. The Indian account of the interaction between insolvency and environmental laws is also presented. The Indian economy also faces the threat of business insolvency risk due to climate change. The paper makes a unique contribution to (a) larger insolvency resolution framework and climate change literature and (b) provides the case for developing a green insolvency regime for India with policy implications.

Keywords: Climate Change, Insolvency, Green Insolvency, ESG, Corporate Governance.

INTRODUCTION

This paper studies the rationale underlying the need for a green insolvency regime in India and its policy implications. Climate change is already a reality. Several countries are moving towards the adoption of climate-friendly policies to mitigate and address challenges presented by climate change. Rising instances of natural disasters such as floods, droughts, forest fires, heatwaves, etc. have led to large-scale destruction of infrastructure and livelihood. The risks from climate change on the economy have many potential implications. Amidst those, this paper draws largely from the literature on the impact of climate change on businesses in general and the risk of business insolvency in particular.[1] It also delves into businesses' interaction with the environment and how actions or omissions by businesses can add to the climate change risks and thus accentuate the exposure of businesses to climate change fallouts.

Instances of climate change-induced business disruptions have been widespread in India. India experienced spells of weak rainfall over 2014-15 and this had damaging effects on businesses in different sectors. Some instances are as follows:

- There was a 12% reduction in tea production in southern India in 2016 due to drought and warmer temperatures.[2]
- A coal power plant in West Bengal shut down for 10 days due to scarcity of water for cooling.
- A survey conducted on business climate risks on top eleven businesses in India (annual revenue up to USD 10.5 billion) expressed concerns over high procurement costs, adapting to renewable energy targets, shifting away from coal intensive energy, low output, and profit margins.

In addition, the recent COP 26 pledge of achieving net-zero emissions by 2070 and scaling down coal-intensive energy sectors predisposes many businesses to financial difficulties and the risk of insolvency and bankruptcy.[3] Going ahead, environmental concerns will assume greater importance within the insolvency and bankruptcy space.

Until recently, studies have explored the impact of climate change-induced risks on the financial and economic health of a country.[4] Economic costs of climate change are bound to increase and the extent of this damage would largely rest on the policies adopted to mitigate it. Findings of such studies suggest that the impact of climate change on businesses stems from two risks. The physical risks are rooted in climate adverse conditions such as extreme weather events like floods, storms, and landslides. The frequency of such risks has increased over time. Businesses that depend on such resources or are located in climate change disaster vulnerable areas face the challenge of the destruction of property and erosion of the value of assets due to such destruction. The second route through which climate change raises business insolvency risk is through 'transition risk'. Several business houses are now transitioning to greener technology to build an eco-friendly and sustainable future.[5] While some firms may have the capital to do so, others may not. In addition, commitments toward achieving climate targets would require scaling down specific businesses in the Indian economy. The scale-down effects combined with the transition of the business to sustainable practices put more businesses at risk of financial distress. This risk must be factored into the laws and institutions of a market economy.

Central banks and financial regulators have recognised the need of integrating risks originating from climate change. Large fluctuations in asset prices due to catastrophic weather-related events need to be offset by prudential policies. This can be done only when the policies incorporate and correct for climate-related risks and potential losses. Amidst many policies that may change, this paper focuses on the insolvency and bankruptcy regime in India. The landmark Insolvency and Bankruptcy Code, 2016 (IBC / Code) transformed the Indian insolvency landscape and strengthened the process of resolution or liquidation of companies in distress, maximising asset value, and securing the rights of creditors and other stakeholders of the corporate debtor (CD). Since its enactment in 2016, the Code has adapted and developed continuously to the changing economic environment. With climate change as a reality and the increased pace of climate-related events, and national-level policy changes on fuel energy, several sectors of the Indian economy will be exposed to not only physical risks but transitional risks of climate change. Businesses are likely to face financial constraints that might lead to the risk of insolvency. Climate change-related events such as floods, droughts will act as impediments to specific industries. The bankruptcy of one industry or firm can have a domino effect and cause the collapse of the supply chain and disturb the market mechanisms. Several firms located in specific states which are more prone to climate-related disasters also face the risk of monetary losses. In addition, increasing compliances and shift towards renewable energy are also using up a large portion of firm resources. The transitional risks can also cause value erosion of a firm's resources. To minimise and manage the erosion of value of assets and efficiently manage the risk of insolvency and bankruptcy, the interaction between climate change and insolvency policy needs to be studied. This reality provides grounds for expansion of the scope of the Code, to strengthen it and to facilitate better management of climate-related financial distress.

In this light, this study, the first of its kind, explores the rationale behind the green insolvency regime and its interface with the IBC. The thrust of the paper lies in providing grounds for developing a climate-sensitive insolvency and bankruptcy regime in the country. In India, the IBC guides the insolvency and bankruptcy proceedings with the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) acting as the Adjudicating And Appellate Authority respectively. Under the IBC, environmental authorities are usually classified as operational creditors (OCs).[6] Treatment of environmental claims also faces certain challenges. They are usually in the form of penalties, damages, or fines that are unliquidated. Attributing exact monetary value to such damages involves calculating the environmental impact's economic cost, which is often not straightforward. The breadth of environmental laws is wide in India. However, this paper's focus is not restricted to analysing the multiple environmental laws and their interaction with IBC. The environment encompasses dynamic elements, out of which climate change-related risks, their impact on insolvency in India, and policy strategies to mitigate and cope will be under focus in this paper.

Although relatively novel, green insolvency or a climate-sensitive framework of insolvency and bankruptcy is an emerging theme of study. Developed jurisdictions such as the United States of America (USA/US), the United Kingdom (UK), and Canada, have made tremendous progress in developing principles and policies in this space with the growing sensitivity to climate change. In this context, the current paper can make a significant contribution to the growing literature that studies the interaction of insolvency frameworks in the backdrop of climate change risks. This paper will be the first to provide a detailed analysis of potential business insolvency risk in India stemming from climate change. Global trajectories will support the case of developing a climate-sensitive framework for India. This paper provides a synthesis of the existing literature on climate-sensitive insolvency regimes which will support further research. Key policy insights flowing from the literature and case study analysis will lay the foundation for policy discourse on the case for a green insolvency regime in India.

The paper highlights the motivation behind the need for a green insolvency regime. It covers the extensive qualitative and quantitative literature that has largely focused on the impact of climate-related risks on businesses in general and business insolvency in particular. The literature also focuses on cross-country evidence on climate-sensitive insolvency frameworks. Following this, the paper defines the research methodology and data sources that have been critically analysed and contextualised. There are three research statements - (a) cross-country evidence on climate-sensitive insolvency regimes, (b) the business insolvency risk in India due to climate risks, and (c) developing accommodative policies for the same. This is followed by a case study on the first climate-related bankruptcy of PG&E and a case study of the landmark decision by the Canadian Supreme Court in the matter of *Orphan Wells Association v. Grand Thorton.* At the end, the paper features the bottlenecks to this research and the interaction of a climate-sensitive regime with IBC.

Why a climate-sensitive insolvency regime?

The interface between environmental concerns and businesses has increased in recent times as climate change and its induced environmental issues have come to the fore. Today, climate change-induced environmental issues affect businesses, and conversely, businesses impact the environment adversely through practices that degrade and damage it.

Climate change-induced environmental issues affect businesses both directly and indirectly. The direct impact is in the form of extreme weather events or natural disasters like floods, hurricanes, wildfires, etc., and the resultant damage to property that pose a physical risk to the survival of all businesses across all types of sectors. Certain businesses are especially vulnerable such as those operating in the energy, transport, agriculture, and forestry sector in which natural resources are key inputs and their scarcity or degradation can severely affect the production activities along with increased costs and supply disruptions. The indirect impact can be in the form of increased regulatory compliance with environmental norms, impact on operational efficiency, increased investment in brand differentiation to retain and expand customer base, availability of capital, and investment opportunities in sustainable and green sectors, etc.

The flip side is that some businesses may themselves engage in activities that invite penalties from environment protection authorities and litigation from affected parties. The damages caused to the environment by businesses can exacerbate the adverse effects of climate change thereby increasing the exposure of businesses to climate change risk. Further, as businesses would be expected to adopt greener practices going forward, the compliance burden /environmental obligations under various laws would entail additional costs, thereby increasing the financial burden of businesses, especially those operating in particularly vulnerable sectors. These costs in addition to other pressures on businesses may nudge them to seek refuge under insolvency/ bankruptcy regime of a jurisdiction to avoid or evade their environmental obligations.[7]

The interface between environmental laws and bankruptcy law did not receive adequate attention until recently. Major indices that measure the effectiveness of insolvency regimes such as the World Bank's Doing Business Report (subsequently suspended by the World Bank in 2021) and OECD's insolvency regime indicator did not assess a given jurisdiction's insolvency framework from the perspective of the treatment of environment obligations of a firm that goes into insolvency and protection afforded to environmental matters in the event of insolvency. This perspective is now gaining traction. The World Bank's new indicator for assessing the investment and business climate of economies worldwide called the Business Enabling Environment (BEE) project is an attempt in this direction. As per the pre-concept note of BEE prepared by the World Bank, the Resolving Insolvency indicator of BEE will *inter alia* address environmental obligations in bankruptcy and review good environment regulatory practices within insolvency proceedings of a jurisdiction.[8] This is a turning point in this insolvency regulatory space as the BEE would encourage jurisdictions to adopt greener regulatory practices in a bid to secure higher rankings in the BEE.

It may be argued that environment policy should be kept distinct from bankruptcy policy. In this regard it is important to note that exogenous policy concerns have always affected reorganisation procedures of corporates. For instance, in the US, railroad reorganisations proceed through structures designed to facilitate national logistical needs and mandatory liquidations of stockbrokers and commodity brokers are intended to protect the investing public from unique risks of the securities industry.[9] Similarly, the objective of the IBC is *inter alia* to promote entrepreneurship, availability of credit, and balance interests of all stakeholders. These objectives have been pursued by the Code through various amendments that strengthened creditor rights, provided a special framework for MSMEs, barred participation of ineligible persons in the resolution process under section 29A etc. This substantiates the plea that if various social and policy interests can justify alterations of bankruptcy procedures and priorities, surely an imminent ecological catastrophe can as well.[10] On a discussion of the interaction between bankruptcy laws and its distributional ends, it is observed that,

> Congressional comments on the Bankruptcy Code are liberally sprinkled with discussions of policies, of concerns about the community impact of bankruptcy, and of the public interest beyond the interests of the disputing parties. These comments serve as reminders that Congress intended bankruptcy law to address concerns broader than the immediate problems of debtors and their identified creditors.[11]

LITERATURE REVIEW

This section of the paper considers the existing literature. Firstly, it covers empirical studies that have studied the intersection of climate change risk, economic and financial costs, and insolvency and bankruptcy. It then progresses to include the literature on the business insolvency risk in India due to climate change and builds on policy evidence from countries that have adopted climate-sensitive frameworks in dealing with insolvency.

Global perspectives

Existing studies focus on the intersection between climate change and the financial health of an economy. Starting with the insurance sector, Doherty (1997)[12] summarises the literature on the impact of climate change on the insurance industry. The rise in instances and severity of climate change risks such as rising sea levels, instances of hurricanes, and temperature rise have led to increased destruction and increased exposure of insurers of the same. Insurers in every sector are exposed to a greater number of claims. Given that climate change has an impact on health, the claims for health insurance may also go up. The paper explains the need for the adaptation of insurance policies to the reality of climate change. It stresses the role of government policy in ensuring the capacity of the marketplace to spread the risk and act as an insurer of last resort.

Climate change risks need to be accounted for in global financial markets. The American study (Saha and Viney, 2020)[13] also supports the earlier finding, that the main channel through which climate change can trigger the financial crisis is the insolvency of insurers. The US stands to lose over 10% of its GDP to economic losses due to hurricanes and flooding. Expanding the study, it is evidenced that developing countries are expected to bear the brunt of the damage accruing to climate change due to lack of mitigation and adaptation strategies, suggesting the need for climate resilience of physical infrastructure and mandatory disclosures of climate risks faced by industries and firms. Rising sea levels and frequent hurricanes in Bangladesh are expected to submerge about 20% of the country. Countries like Kiribati face the threat of complete submergence. It is not to say that losses to developed countries are low. However, in the face of this threat, unlike developing nations, developed nations like the US has a deep financial market that can raise funds and insure market agents against climate change's economic and financial shocks.

The report by the Climate Disclosure Standard Board (CDSB)[14] presents an account of how climate change can give rise to financial risks in the face of corporate governance irregularities. The lack of environmental disclosures distorts investment decisions. The way capital is invested and managed is bound to undergo changes in the face of rising climate-related events. The CDSB suggests harnessing the strength of stock markets and corporate climate disclosures to avoid and manage business failures due to climate change risks. In the face of insolvency or at the very threat of it, climate disclosures will play a key role in identifying the viable and non-viable parts of the business. The role of insolvency regulators and public policies in ensuring such disclosures and incentivising sustainable practices cannot be ignored. The current paper draws traction from the above reasoning.

Given the imminent risks of climate change on the financial and economic growth of a country, it becomes imperative to mainstream climate change into financial governance.[15] Efforts focused on shifting investments to a more climate-resilient economy through carbon pricing, emission reduction, and novel policies require multiple financial instruments. In addition, policy coherence between financial and regulatory institutions of the country is of prime importance. Policy coherence and mutually reinforcing policy regimes, with minimal contradictions, are crucial for developing climate-sensitive frameworks (Zou et. al, 2015). Zou et. al study and quantify the sovereign risk arising out of credit default. Domestic as well as international exposure to default due to climate change-related devastation (in the form of higher insurance payouts to corporates, loss of property, fall in asset value, large economic bailouts) increase the sovereign debt. The study finds that the European Central Bank would have to exclude several issues from the portfolio to align with a 50% carbon footprint reduction. Accepting the inevitable reality, central banks in France and Sweden have reoriented investment strategies accounting for climate risk exposure. The study concludes that monetary, prudential, and regulatory policies need to be in tandem for efficiently managing sovereign insolvency risks arising from climate change.

A novel study on mitigating climate change through bankruptcy reform in the US (Gouzoules, 2022)[16] reveals the key benefits of incorporating a climate-sensitive framework into the US Bankruptcy Law. The study highlights several benefits of this framework such as preservation of asset value, efficient strategies related to the management of loss-making fossil fuel industries, and appointment of new personnel to ensure sustainable practices. This study is further explored in the first research statement of the current paper.

In the Indian scenario, there are multiple financial instruments that are targeted at meeting climate goals. Green bonds and increased and easier foreign investment in green projects are increasingly used to meet India's nationally determined contribution. Green bonds have been used to raise funds for decarbonisation, waste management, supporting renewable energy growth etc. However, the realisation of the benefits of green bonds relies heavily on economic and financial infrastructure. There will be an inherent risk of failure due to high costs (which may be due to taxes, duties, and other inputs).[17] Also inherent is the risk of failure of a business that is transitioning to adopt climate-friendly strategies. Zou et. al's emphasis on prudential and regulatory policy coherence suggests that there is a crucial role that an insolvency resolution framework such as the IBC would play in the face of such climate-induced insolvencies. The emphasis on the role of regulatory policies is the essence of the current paper. It builds on the above theories of coherent policies and attempts to open a window for climate-sensitive insolvency policies in India.

The initial circumstances of each country in terms of its climatic conditions, socio-economic setting, and growth prospects will have an impact on the scale of social, economic, and environmental impacts of climate change.[18]

India's vulnerability to climate change

Among the most significant impacts of climate change on India is increased variability and uncertainty in monsoon patterns leading to adverse impacts on agricultural productivity and food security.[19] Further, as per the 2022 Inform Risk Index,[20] India has one of the highest disaster risk levels in the world (ranked 38 out of 191 countries) with high exposure to disasters such as floods, tropical cyclones and drought. Occurrences of such extreme weather events are likely to rise going forward, impacting both lives and livelihoods. India's vulnerability to climate change fallouts is exacerbated by its high social vulnerability or high levels of socio-economic deprivation.[21] Rural areas are particularly vulnerable to the impacts of climate change as they lack the resources to adapt and are highly dependent on the local, climate-sensitive natural resource base, including water and food.[22] Thus, climate change adversities coupled with socio-economic vulnerabilities will have an impact on businesses in India and affect their operations, revenue and profitability.

Climate change and risk to businesses

The aforesaid fallouts of climate change will impact businesses depending on the individual set of factors of a business such as location, sector, factors of production employed, etc. However, the general impact of climate change on the majority of businesses will be similar.[23] For instance, rising temperatures will impact energy consumption by businesses and indirectly affect the productivity of workers as well. Variability in precipitation will have indirect impacts on yields, building, sewage, and groundwater recharge. The demand for water by Indian industries is estimated to more than triple by 2025.[24] The declining availability of fresh water coupled with increasing demand will adversely affect the cost and productivity of highly water-intensive industries. Hikes in energy prices are likely to hit the energy needs of India which are expected to triple by 2025.[25] Further, regulatory requirements for businesses at the national and state level are likely to become more stringent going forward, especially in terms of emission cuts and consumption of resources.[26] Exporting businesses will also be required to adhere to importing countries' environmental standards in this regard.

Climate change risk is being widely acknowledged by business houses in India. As per a recent survey[27] Indian companies estimated the total inherent financial impact of climate risks to be ₹ 7,138 billion with an average risk per company being ₹ 92 billion. Nearly 90% of the companies surveyed included the risk of current regulations, emerging regulations, and reputation in their climate change risk assessments. This was followed by transition risk posed by changes in the legal framework, policy and technology. The surveyed companies also assessed the risk of climate change on their value chains and figured that direct operations would be most affected due to acute and chronic physical risks posed by climate change along with emerging and current regulations. As regards the downstream value chain comprising the company's customers and clients, the companies assessed market risk viz. changing customer behaviour and demand for low carbon-intensive products or sustainable products to be a major risk affecting customer retention and expansion.

Studies have indicated the potential losses to specific business sectors in a scenario of climate inaction. The most impacted sectors would be services (government and private), manufacturing, retail and tourism, construction, and transport, with these sectors experiencing an annual average loss in the value-added to GDP of more than USD 1.5 trillion per year by 2070.[28] The impact of climate change is expected to most significantly impact the availability of labor and physical capital and as a result industries that rely on these factors of production will be affected the most. The MSME sector is particularly vulnerable to risks.[29] MSMEs are characterised by insufficient infrastructure, limited capability to upgrade to greener technologies, and limited resources to buffer against disruption in cash flows. Further, being at the bottom of global supply chains as suppliers to big corporations, MSMEs are not as well equipped as large corporations in internalising climate risks through vertical integrations.

Environment protection laws and businesses in India[30]

Protection and conservation of the environment and sustainable utilisation of natural resources have been given importance in the constitutional framework of India. The Constitution of India under Part IV (Article 48A - Directive Principles of State Policies) stipulates that the State shall endeavour to protect and improve the environment and safeguard the forests and wildlife of the country. Several environment protection legislations have been put in place by the State such as The National Green Tribunal Act, 2010 (NGT Act), The Air (Prevention and Control of Pollution) Act, 1981 (Air Act), The Water (Prevention and Control of Pollution) Act, 1974 (Water Act), The Environment Protection Act, 1986 and The Hazardous Waste Management Regulations, etc.

These environment protection and conservation legislations are applicable to all types of businesses operating in different sectors of the economy. These legislations impose varying degrees of penalties on companies for non-compliance with various provisions. For instance, the Central Pollution Control Board (CPCB) uses a formula to compute environmental compensation to be levied on a company that has failed to comply with various permits required under the Water Act and Air Act. The National Green Tribunal (NGT) can order relief and compensation to the victims of pollution and other environmental damage; restitution of property damaged and restitution of the environment, and a company that fails to comply with any order of the NGT is punishable with a fine of up to ₹ 25 crore (section 26(2) of the NGT Act). Similarly, under the Water Act, companies who cause water pollution can be ordered to clean up the pollution caused and pay compensation to remedy the polluted environment, or to possible victims. Apart from the orders of the NGT, the Supreme Court and High Courts have also adjudicated in the past on environmental lapses by companies. For instance, in the matter of *Sterlite Industries(I) Ltd v. Union of India & Ors.*[31], the damages or compensation payable by the company for operating without a valid environmental permit for 15 years was assessed to be ₹ 1 billion by the court.

Other than penalties for contravention of various environmental laws, there are some forms of environmental taxes imposed on certain goods. For instance, in the Delhi-National Capital Region (NCR), one percent of the ex-showroom price is charged as Environment Compensation Cess (ECC) on diesel vehicles having an engine capacity greater than 2000 CC. Similarly, an ECC is levied on HGV vehicles entering the NCR. Recently, the Ministry of Road Transport and Highway approved the proposal to impose a 'Green Tax' on vehicles older than 15 years.

Environment-related disclosures in India

Presently, under the Companies Act, 2013 there are no mandatory corporate governance requirements relating to climate change as such. It was not until recently that the first of its kind environmental-related disclosures for companies in India was introduced by the Securities and Exchange Board of India (SEBI) in May, 2021 called the Business Responsibility and Sustainability Report (BRSR). The SEBI has made filing of BRSR mandatory for the top 1000 listed companies by market capitalisation starting from the financial year 2022-2023. The scope of environment-related disclosures sought by SEBI, *inter alia*, includes the following:[32]

- Details of direct and indirect GHG emissions and GHG intensity.
- Details of total energy consumption and energy intensity (including break-down of total energy consumed from renewable and non-renewable sources).
- Details of total water withdrawn and consumed, and water intensity ratio.
- Whether the company has adopted a zero liquid discharge policy.
- Air emissions.
- Details of waste generated, recycled, re-used and disposed of, and a description of waste management practices.
- Details of EIAs.
- Impact on biodiversity.

From the aforesaid discussion, it is clear that businesses' interface with the environment directly and environmental laws and disclosures as per law have gained immense momentum in recent years in India. With increased exposure to environmental risks, the aforementioned factors can accentuate the underlying financial stress of firms, leading to solvency problems. Climate change has become an important factor in the decision-making process of firms. In the event a company enters the insolvency resolution process, going forward, climate change will also affect its insolvency resolution prospects.

RESEARCH METHODOLOGY AND DATA SOURCES

A preliminary study of the data on resolution plans of CDs resolved under the Code, as available with the Insolvency and Bankruptcy Board of India (IBBI), has revealed that there are no explicitly mentioned environmental claims in the claims of creditors admitted by the resolution professionals.[33] Hence, secondary sources of data available in the public domain have been used to answer the research statements. A meta-analysis of literature has been undertaken to provide cross-country evidence on the treatment of environmental claims and adoption of climate-sensitive policies. Empirical evidence of economic and financial losses due to climate change has been included. This provides trends and evidence to support the research statements.

Multiple secondary sources have been used to answer the research statements and develop a case for a green insolvency regime in India. Reports from leading research and insights teams of multi-national companies have been used (such as KPMG, Deloitte) to support the statements and provide evidence. Publications from Oxford Law, OECD, British Columbia, Journal of International Affairs and Task Force on Climate-Related Financial Disclosures (TCFD) have been used to conduct a meta-analysis of the literature and set a green insolvency policy context for India. This paper features both quantitative and qualitative arguments.

LITERATURE ANALYSIS

This section of the paper presents a literature analysis. This analysis is balanced with research papers that are rooted in empiricism as well as those that are purely based on policy. The narrative below highlights the progress made by several nations in adopting a climate-sensitive insolvency and bankruptcy framework. It discusses the policy changes undergone in the US, UK, and France. Borrowing from the experiences of foreign jurisdictions and given the current treatment of environmental claims in India, this section also discusses the need for a green insolvency regime given the business insolvency risk in India posed by climate change.

Research Statement 1: Cross-country comparison of existing provisions in insolvency law and treatment of environmental claims.

In general, the environmental laws of a country are designed to preserve and protect the health and safety of the surroundings. This is achieved through enforcing accountability and liability, compensating for externalities, and effectively restoring the habitat. The bankruptcy law aims to protect the interest of the debtors and creditors, maximise the value of assets, and supports a plan for reorganisation or revival of a distressed firm. However, there are conflicting elements between the environmental and bankruptcy laws. It is important to note that strong environmental laws are essential to mitigate and adapt to the physical and transitional risks that climate change presents. Although environmental laws deal with aspects beyond climate change risks, the latter can be adapted after certain changes in environmental laws.

Several case laws of different jurisdictions have been summarised below. These are accounts where environmental concerns have taken precedence. The rationale behind highlighting such cases is that in the light of climate change, environmental claims are only going to increase. Devastation due to natural and man-made disasters, rising temperatures, and fires are a few examples in this regard. Land degradation is a major contributor to climate change (Stockholm Environment Institute) and going forward, there is a possibility that stricter environmental laws on the same could follow (as seen in the case laws below). Several firms could go into insolvency if climate change risks are not accounted for, and managing the same will be at the forefront of insolvency regimes.

United States of America

Firstly, examining the case of the US, the US Bankruptcy Code has been often a haven for creditors to forego their environmental obligations, under the automatic stay route. It has been used to avoid the liabilities and costs associated with cleaning up and restoration (Gelbar et.al).[34] Environmental obligations of the debtor are viewed to increase the burden to the detriment of creditors, and therefore, environmental claims are treated on a case-by-case basis. There are little to no absolute guidelines on dealings of environmental matters in insolvency and bankruptcy. However, this is not to suggest that environmental claims find no place in the US Bankruptcy Code. On a case-by-case basis, it has been observed that the debtor even after reorganisation cannot ignore its environmental obligations. The debtor is expected to comply with the environmental laws. The US government has the option to undertake the clean-up itself and obtain reimbursement from the debtor. There have also been instances where reorganisation plans have been stalled due to the debtor's inability to satisfactorily demonstrate that it could adhere to the environmental laws.[35]

In the matter of *Commonwealth Oil Refining Co.,* the Environment Protection Agency made it mandatory for the debtor to comply with the environmental laws. The debtor was required to spend money to fulfill these compliances before its reorganisation plan was filed.

In the *Midlantic National Bank v. New Jersey Department of Environment Protection, (1986),* the US Supreme Court considered the abandonment of property containing toxic waste. However, this decision was taken to the Court of Appeals after objections from the State of New York, citing it as a threat to public health and safety. The Supreme Court then decided that the trustee could not abandon this property. This was the broad interpretation that specified conditions before the abandonment of property containing toxic waste.

United Kingdom

The UK has also witnessed a rising number of cases where environmental liabilities are not met by an insolvent debtor. However, what follows, is a similar trajectory to that of the US where environmental obligations are examined on a case-by-case basis.

In the case of *Mineral Resources Ltd. (1999)*, the Court ruled that Environmental Protection Act (1999), did not allow the termination of the waste license of the insolvent company, on the grounds that maintenance of a healthy environment would be prioritised. Such a decision also sheds light on the increasing environmental compliances companies will have to face, and climate change risks will only further it. This creates a need for incorporating environmental risks that flow from climate change into insolvency management.[36]

A welcome change that rectified a lacuna in the insolvency procedure in the UK is the Rating (Coronavirus) and Director's Disqualification (Dissolved Companies) Act, 2021. It prevents the company directors from dissolving a company (either without being compelled to place it into insolvent liquidation or to avoid an investigation of misconduct or payment). It stemmed from the concern that creditors who restored the company put it for liquidation right after. However, there is an unintended consequence or rather a positive externality that flows from this Act. There is now less room for those creditors that sought exit to avoid the impending environmental liabilities and costs post-restoration of the company.[37]

The changing environmental obligations along with the principles of ESG – environment, social, and governance, comes with changing costs that are to be borne by the company and naturally its creditors. However, this change is inevitable. Climate change realities call for a shift of energy resources, geographical shifts of industries, and overall restructuring to comply with the laws. The above-mentioned Act now prevents the closure of struggling businesses due to such reasons. This is particularly important in the face of climate change. A climate-sensitive framework dissuades firms from winding up to avoid environmental remediation costs.

France

In the French scenario, it is mandatory for the Liquidator to order an environmental consultant to deal with matters concerning the same. The consultant is expected to provide detailed reports on the environmental obligations (remediations) of the insolvent. The funds are also to be acquired from the insolvent's assets if available.

The evidenced clashes between the environmental law and bankruptcy law of nations suggest the need for policy coherence. The prime reason behind changing ESG principles is the reality of climate change and the importance of adopting sustainable practices. Recent judgments in the US and developments in the UK signal a positive turn towards accounting for a ‘greener’ insolvency regime. A clear shift is seen in these judgments towards environmental protection.[38] The future holds only more environmental obligations due to potential climate change risks and damages, thus a framework with due environmental consideration needs to be developed.

Research Statement 2- Impact of climate change on business insolvency risk in India and interface with insolvency resolution framework

The impact of climate change risk on businesses in India has been examined in detail in this section. It also discusses the gap between conflicting policy considerations of environmental laws and insolvency law. The insolvency resolution process for companies in financial distress is governed by the IBC in India. With the enactment of the Code, a modern insolvency and bankruptcy regime was established in the country that provided for a codified and structured market mechanism for resolution of firms in distress or liquidating firms that cannot be resolved, and freeing up scarce economic resources for productive use. On the face of it, the objective of an insolvency resolution legislation is to provide the debtors with a fresh start, preserve the assets of the company, ensure equitable distribution of realisations to creditors and discharge the debts of the company through a resolution or reorganisation plan.

The Code provides for a corporate insolvency resolution process (CIRP) to resolve a CD and a liquidation process for liquidating an unviable CD. In its present form, the Code does not dole out any special treatment to environmental obligations or environmental claims of a CD. There are various stages during which the environmental obligations of the CD under various environment protection laws interact with the insolvency law during the CIRP or liquidation process. Some of these stages are discussed below from the perspective of how the law is not adequate in its present form to cater to environmental protection and fallouts of climate change.

Moratorium: Under the Code, as soon as the application for initiation of CIRP against a CD is admitted, the Adjudicating Authority (AA) passes an order declaring moratorium or ‘automatic stay’ under section 14 of the Code. During this period, the CD is protected from new or pending suits, enforcement of security interest, and transfer or disposal of any of its assets. The objective of moratorium is to keep the CD as a going concern and provide a ‘breathing space’ to conduct the CIRP and take the process to its logical end. From the perspective of environmental obligations of the CD, it is understood that any lawsuits concerning environmental violations on part of the CD will come to a halt during CIRP. The Code at present does not provide an exception to the enforcement of environmental laws and regulations to this automatic stay provision.

Provision for moratorium exists in the insolvency laws of mostly all the jurisdictions. Taking note of the importance o f governmental enforcement of laws and regulations pertaining to the environment, the US Bankruptcy Code was amended in 1998 to provide an exception to the automatic stay provision by allowing commencement or continuation of proceeding or action by a government unit under various environmental protection laws.[39] However, there was an ‘exception to the exception’ of the automatic stay which prohibited governmental units from enforcing money judgments. This was done to prevent such government units from receiving preferential treatment against claims of other creditors of the firm. The exception to the exception rule has been interpreted differently in different cases by the US bankruptcy courts, allowing or not allowing for the same, depending on the gravitas of environmental violations of a firm.

Given the realities of climate change, there is a case for tweaking the insolvency framework to this effect.

Treatment of environment claims:[40] An environmental claim or liability can be in the form of a direction by the courts/authorities to clean up the contamination caused or pay the government authorities for clean-up, pay for damages to those affected, recovery of damages as arrears of land revenue etc. There may be cases wherein the CD and another party may be liable, jointly and severally, to pay for the damages.

Presently under the Code, environmental claims are treated as unsecured claims of the State who is an OC under the Code. Claims of OCs are settled by the resolution applicant as per the terms of the resolution plan, such that OCs receive at least as much they would have in case of liquidation of the CD. If the CD is liquidated, then these claims will be settled as per waterfall mechanism of distribution of proceeds as per section.[53] Thus, since environmental claims will fall fairly below in the waterfall's hierarchy, it is likely that these claims may not be paid in full.

In the case of ongoing litigations concerning environmental liabilities of a CD, it may be difficult to ascertain the cost of clean-up that has not occurred yet, estimate the damage caused, and the cost of remedying the contamination. In such a scenario, there may be cases where a notional amount may be provided for in a resolution plan as contingent claims. However, the fallout is that sometimes a very small, almost a negligible amount may be provided for as a contingent claim, as was done in the CIRP of Essar Steel India Limited. Such practices can be harmful in efforts to hold a company liable for damages caused to the environment. It is imperative that the insolvency framework provides for a differential treatment of environment claims as such claims have a larger bearing on the ecology and a jurisdiction's efforts in mitigating climate change.

Treatment of burdensome contracts: Insolvency frameworks do generally provide for the rejection of overly burdensome contracts (those contracts in which the cost of performance is greater than the benefit to be received). Under section 20(2)(b) of the Code, the Interim Resolution Professional has the authority to amend or modify the contracts or transactions which were entered into before the commencement of the CIRP. Similarly, under regulation 10(1)(d) of the IBBI (Liquidation Process) Regulations, 2016, a Liquidator may reject overly burdensome / unprofitable contracts. From the lens of environmental protection, such provisions may be misused by the CD to vacate or terminate the lease of contaminated property and put the onus of remediation on the owner of the property.[41] This could also create perverse incentives to take a company into liquidation.

Environment claims as costs to the estate: Under the Code, insolvency resolution process costs have super-priority, that is, they are paid in priority over all creditors. At present, environmental damages/ claims/clean-up costs claimed by government authorities are not treated as operational debt. There is a case to include such claims as part of insolvency resolution process costs or administrative expenses. The same has been done on a case-by-case basis in many bankruptcy cases under the US Bankruptcy Code. The courts in the US have allowed clean-up costs as part of administrative expenses mainly on two grounds. First, companies that undergo Chapter 11 proceedings must comply with state environmental laws and cleanup orders as a condition for continued operations. The rationale behind this is that a company should not be able to avoid compliance with environmental laws and gain a competitive advantage *vis-à-vis* others simply by filing for bankruptcy.[42] Secondly, the cleanup enables the estate to maintain itself in compliance with applicable environmental law and is thus an actual, necessary cost of preserving the estate.[43] Jurisprudence in the US indicates that courts are more willing to treat environmental claims as administrative expenses if the claimant is a government authority and less willing if the claimant is a private agency (including landlords). If clarity on treatment of such claims find mention in the legislation itself, it would bode well for environment protection efforts of the government.

From the aforesaid discussion, it is inferred that while both environmental laws and insolvency law promote societal good, the conflicting interests and policy considerations that arise when the two legislations interact, can be challenging to resolve by courts. Going forward greater clarity would be required to bring the two laws together in harmony.

Research Statement 3: Integrate environmental and climate change issues in bankruptcy laws and policy implications/prescriptions

Governments across the world have integrated environmental and climate change concerns into their insolvency and bankruptcy regimes. The matters of environment, climate, and climate change-induced insolvency are no longer treated in isolation from one another. Governments across the world have recognised and borne the brunt of climate-induced disasters. Huge monetary and non-monetary losses have stressed current and future livelihoods. In this light, regulatory authorities, courts, and government institutions in several countries have tried to achieve policy coherence, giving greater significance to matters of climate change. Dynamic and new policies have been adopted in different jurisdictions. These include:

(a) Case laws from the US, UK, and France, signal how countries deal with matters of environmentally sustainable insolvency and in several instances accorded priority to the environmental obligations of the debtor. Even though the matters are dealt with on a case-by-case basis, it sends a strong signal to the countries which have let corporate laws override environmental concerns. Policy prescriptions are offered based on the above analysis. These include policies for the development of climate-sensitive frameworks through managing the clash of environment and bankruptcy laws, provision of incentives for new investments, and capacity building.

(b) The second policy implication that flows from the analysis of the literature in this paper is the use of incentives. Incentives in the context of climate-induced insolvencies are not restricted to prudential (monetary incentives) in the form of subsidies or funds that allow restructuring. They may be extended to providing mandatory environment disclosures in return for new investments / revival. Climate stress tests on the firm's assets and revival prospects will help the creditors and the firm efficiently assess its viability in the face of potential climate risks. Literature suggests that climate disclosure of firms may be introduced when a firm files for insolvency and bankruptcy. The regulator then ensures that such forms are provided to creditors. Several innovative opportunities are also expected to flow from climate disclosures. India is now attracting large investments – both domestic and international, to firms at the forefront of adopting sustainable practices. Restructuring and revival of firms on climate-sensitive principles can attract greater funds and aid the firm as a 'going concern'.

(c) The study by Linna (2020)[44] offers unique perspectives and policy suggestions on business sustainability and insolvency proceedings. It suggests that even when a firm is insolvent, it may have other valued resources. The firm may possess high-performing professionals, a high brand reputation, strong supply chain networks and advanced technologies. Drawing from this theoretical framework, some businesses may possess elements that are adaptable to climate change. Given this scenario, parts of the business that have adopted sustainable practices, that shield them from further climate-induced risks can be revived.

(d) Fourth, borrowing from the French and Canadian experiences, there need to be capacity building efforts that support the development and execution of a climate-sensitive framework. The asset reconstruction companies (ARCs) in the Indian scenario can play a major role in this. Building expertise in handling matters related to environment preservation, climate-induced insolvencies can be supported by professionals who are part of ARCs. They can be supplemented with climate risk disclosure forms for insolvent firms. This would allow evaluation of the firm along with the ESG principles and unravel new opportunities for investment.

CASE STUDIES

The case studies discussed in this section highlight the landmark decision in Canada where environmental obligations came first before any other payments were due. This is followed by another case study of what is termed the world's first climate-change bankruptcy that happened in the US.

Canadian Experience

Canada has been the leader of the pack in steering towards a climate-sensitive insolvency regime. The Ontario Court of Appeal recognised that *'climate change poses an existential threat to human civilization.'* [45]

> The uncontested evidence before this court shows climate change is causing or exacerbating: the increased frequency and severity of extreme weather events (including droughts, floods, wildfires, and heatwaves)... Recent manifestations of climate change in Canada include: major wildfires in Alberta 2016…, major flood in Ontario…tied to climate change.[46]

In addition to the physical risks mentioned above, there are transition risks that Canada faces in shifting to a low carbon economy. About 14.4% of the economy relies on the sale of coal, oil, gas, and extraction and refining.[47] Multiple sectors face the risk as global investors shift portfolios to renewable energy, low-carbon investments. Climate change is a reality for every country, and the Canadian experience has set a precedent for many others.

In the famous case of *Orphan Well Association v. Grant Thorton Ltd.* (also known as Redwater),[48] Redwater, an oil and gas company in Canada became insolvent in 2015. A provable claim is entitled to payment under the Bankruptcy and Insolvency Act of Canada (BIA). The province of Alberta also has laws regarding the operation of oil and gas companies such that they are licensed and non-transferrable in nature. Upon winding up of such companies, the companies are required to 'abandon' the pipelines and wells and 'reclaim' or restore the land. In the event of insolvency, the cost of restoring dry wells and pipelines would amount to millions for the company. Post Alberta's Court of Appeal decision, Redwater would disclaim the unprofitable assets, which in this case were the un-restored land and dry wells. Such abandonment could be done under the BIA (which is a Federal law). However, the provincial laws of Alberta were in conflict with the 'disclaiming' of assets.

This issue was then decided by the Supreme Court of Canada which ruled that the trustee could not disclaim the site in favor of the Alberta Energy Regulator. It also ruled that the environmental obligations of Redwater could not be ignored whether paid by their own money or not. In the case of Redwater, the assets had already been sold and held in a trust. The implication of Supreme Court's ruling was that now environmental obligations were to be met first before any other payouts were undertaken. The environmental liabilities arising from abandonment and reclamation were to be satisfied prior to any other claim. This is a landmark decision since environmental obligations do not receive top priority in matters of insolvency.

Since this decision of the Supreme Court, the Alberta Energy Regulator has worked with several trustees and receivers to best understand the environmental impacts, effects of climate change on raising constraints and developing the best strategies to mitigate them.[49]

In addition to this decision, in 2019 the Canadian Securities Administrator issued the following:

> climate change-related risks are a mainstream business issue. Issuers should consider these risks as part of their ongoing risk management and disclosure processes and they must disclose any such risks that are material to their business.[50]

Canada has also integrated climate-sensitive frameworks in the assessment of financial stability and review of the solvency of firms. Sarra (2019) suggests that CAD 2 trillion would be required for Canada to meet its international climate targets. It argues that the shift in terms of policy and also investments will render firms that are unable to adapt to climate realities insolvent.

The case of PG&E[51]

The first known case of climate change bankruptcy was declared in January, 2019 when California's biggest electric utility, PG&E went under as a result of liabilities crossing USD 30 billion due to California wildfires that occurred between 2017 and 2018. The California Department of Forestry and Fire Protection claimed that it was PG&E's equipment that caused the wildfires. Assessing that the settlement for these damages would cost the utility USD 30 billion, PG&E pre-emptively filed for Chapter 11 bankruptcy under the US Bankruptcy Code in 2019. While the technical lapses by the company may have caused the wildfires, research on this case has indicated that conditions that were caused by climate change made the fire more likely to occur and caused damage. Researchers also noted warming average temperatures in the State coupled with diminished autumn rains and increased winds which led to tinderbox conditions as brush and vegetation become drier and more prone to burning.[52] All these factors together contributed to the wildfires and subsequent damages that led PG&E to bankruptcy.

The bankruptcy of PG&E prompted a unique policy response from the State of California to allocate the costs of future wildfires. The State enacted wildfire insurance legislation that addressed financial risk because of climate change. The legislation *inter alia* indicates the maximum liability of shareholders of a utility towards payment of damages caused by wildfires. Most importantly, the law created a USD 21 billion insurance fund and set up a Wildfire Safety Advisory Board to review specific safety requirements of utilities and recommend the issue of a safety certificate to the utility. The issue of this certificate would be a prerequisite for getting access to the insurance fund. This serves as an incentive for utilities in California to take adequate safety measures and adopt greener practices if they wish to be rescued in case of climate change-induced calamity.

The example of PG&E's bankruptcy is an indication that climate change can trigger financial stress in companies leading them to file for bankruptcy. The spillover of such climate change-induced bankruptcies is increased cost of debt and a fall in equity valuations. The most important question posed by this bankruptcy was the payment of damage caused by climate change-induced extreme weather events in a manner that protects consumers but at the same time maintains the financial viability of such companies. The regulatory frameworks going forward have to account for the allocation of such climate costs that may drive a company to bankruptcy. The delicate balance between accountability and financial stability will be key to managing climate risk in various sectors, particularly those that provide public goods.

POLICY IMPLICATIONS AND LIMITATIONS

Implications and suggestive measures in the insolvency space

Climate change has become an important factor in the decision-making process of firms. In the event a company enters the insolvency resolution process, going forward, climate change will affect its insolvency resolution prospects. For instance, a resolution applicant's assessment of the turnaround potential of a firm would include the current carbon footprint of the firm and the potential for technological innovation and deployment of energy-efficient processes to reduce the same.

Climate change could also affect the valuation of assets of the insolvent firm. The reputational damage caused by climate change-induced insolvency could also adversely affect the going concern value of the business.

Institutional investors of today prefer to quantify their exposure to assets that are carbon linked in their investment portfolios. Going forward banks may also shift lending away from carbon-intensive businesses to greener businesses.

Insolvency professionals handling climate change-induced insolvencies will have to ensure effective corporate governance including climate change disclosures, arrange for interim finance and manage several types of claims arising from acute events or chronic climate impacts. Insolvency of larger businesses could have a domino effect leading to small business insolvencies. The courts adjudicating on insolvency matters would also have to bear in mind the evolving public policies and regulatory frameworks in response to climate change while approving the resolution or liquidation of a company.

There is also the risk of feedback loops developing between the effects of climate change on the real economy and those on financial markets. Banks, insurance companies and asset management firms are high-impact sectors in this regard. According to the Financial Stability Board (FSB), increased physical risks associated with climate change could result in both market and credit risks to the financial system, reducing the value of investments, and increasing risks to lenders and other financial market participants. Further, this may alter the behaviour of financial institutions such that banks may reduce lending and insurers may reduce insurance coverage, leading to an overall reduction in their support to the real economy. In the context of the insolvency resolution framework in India specifically, going forward policymakers will have to consider structuring insolvency law that is sensitive to environmental matters. For instance, the law may provide for differential treatment of environmental claims and liabilities of a CD. Provisions of moratorium may provide for exceptions for litigations related to environmental claims and damages. Similarly, claims of environment protection authorities may be made a part of administrative expenses / insolvency resolution process costs and paid in priority in full. The law may provide also for safety checks to ensure that firms do not use the insolvency channel to shirk off their environmental obligations. To this effect, the Insolvency Professional and the AA will have to examine those contracts of the CD closely that may have been identified as overly burdensome to ensure that they do not involve environmental aspects. The law may also provide for alternatives to transfer contaminated properties of the CD as part of resolution plan to a trust that could be bestowed with the responsibility of clean-up. The resolution plan may provide for funding and terms of administering such a trust.

The case of PG&E points to the importance of having a link between the adoption of preventive measures by companies to mitigate climate change risks and cost recovery, thereby incentivising companies to take appropriate steps to mitigate damages. Such incentive structures strengthen the case for 'resolvability' as a concept that corporates may adopt going forward to expedite the rescue of the company in the event of looming insolvency. Furthermore, the FSB's TCFD is a step in the right direction to improve and increase reporting of climate-related financial information by corporates. This would enable lenders, investors, and insurers to assess the viability of corporates as regulatory structures evolve, new technologies emerge, and consumer behaviour shifts to greener products and services. Various ratings agencies, data companies, and actuaries would also need to develop a new set of metrics to measure the resilience of companies to climate change risks for the benefit of financial institutions and investors.

Limitations

As regards the limitations of this study, at present the availability of official empirical data in the context of environmental claims in insolvency cases is sparse, thereby making the process of formulation of bankruptcy policy in this context a challenge. Going forward, the task of calibrating the ideal balance between striving for the highest degree of environmental protection and curbing the negative effects of a company's failure will be of prime importance in the development of this area of legislation.

CONCLUSION

This study builds a case for the need for a climate-sensitive insolvency regime. The impact of climate change on financial structures and economic growth has been well recorded in the existing literature. However, the interaction of insolvency policies and sustainability studies has been restricted to the Canadian experience. The current study makes a novel contribution by synthesising and analysing the wide literature on climate change and insolvency risks. It presents compelling arguments and evidence from the world and specifically from India to draw attention to the need for a 'green insolvency regime'. It offers a meta-analysis of the literature from different jurisdictions by highlighting their dealings with environmental claims. It presents case laws from multiple jurisdictions highlighting the rising environmental claims. Given that climate change can cause damages, both physical and transitional, such claims will only see an increase. Effective management of them would require developing strategies and policies that achieve policy coherence.

However, the crucial aspect of the paper lies in the empirical evidence provided for different jurisdictions and the case for India. Cross-country evidence suggests several ways in which insolvency regimes can be more climate-friendly. Merely incentivising firms to adopt sustainable practices through prudential frameworks will not be sufficient. Going forward, climate disclosures will be crucial in the assessment of the viability of firms. The revival strategies and valuation of assets will have to be based on how sustainable they are and what risks they face due to climate change risks and mitigation policies.

The IBC along with the regulator and other key pillars of the insolvency ecosystem will have to incorporate climate-sensitive elements to effectively manage losses to companies that arise out of direct catastrophes and reorganisation based on sustainable principles. The law itself will have to carve out certain exceptions for dealing with environment claims and obligations of the distressed firm. The regulatory framework may also provide for climate disclosure forms and other instruments which may appraise the creditors and debtors of their risks and opportunities. It can pave way for large technological investments that can revive the firm. Several opportunities in the green stock market can be harnessed to finance the reorganisation and revival of firms. ARCs can develop expertise that helps adapt to and mitigate challenges presented by climate change.

As Mark Carney, Governor Bank of Canada (2008-2013) and Governor, Bank of England (2013-2020) rightly formulated '*businesses that fail to adapt to climate change, including companies in the financial* *system, will go bankrupt without question, and yet there are great fortunes to be made*.' While climate change poses significant challenges for businesses going forward, not all is lost as the latter also presents opportunities to make businesses more competitive and unravel new market opportunities.

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22

OWNERSHIP, BANK APPOINTED DIRECTORS AND FINANCIAL DISTRESS:

EVIDENCE FROM INDIA

—Sumit Banerjee and Swechha Chada

Executive Summary

As everyone works to maximise their own private value, the nature of ownership of firms impacts how every class of owner view risk-taking behaviour. The socioemotional wealth theory states that controlling shareholders work to preserve their socioemotional endowment in the businesses. The controlling shareholders are willing to take decisions that are detrimental to the economic health and longevity of the firm if that allows them to preserve the socioemotional endowment. Using the socioemotional wealth theory, we hypothesise that in order to preserve the socioemotional wealth, the controlling shareholders are more likely to invest in high-risk projects that increases the probability of financial distress. Additionally, we state that institutional owners and bank appointed directors play a monitoring role on the board and help steer the firm towards a longer period of survival and steady profitability. We test these hypotheses on Indian firms. Contrary to our expectations, we find that the probability of distress reduces with the socioemotional wealth of the firm and increases with institutional owners and the presence of bank appointed directors. This study adds to the literature by explaining how the socioemotional wealth of the firm helps in preserving the wealth rather than increasing it by investing in riskier projects. It also shows that institutional investors and bank appointed directors do not effectively perform their monitoring role.

Keywords: Socioemotional wealth, Institutional Investor, Bank Appointed Directors, Financial Distress, Corporate Governance.

INTRODUCTION AND MOTIVATION

Agency theory proposes that every stakeholder works for their own value maximisation, which may not be in the larger interest of the firm. In Indian market, the major stakeholders are the promoters, financial institutions, corporate bodies, foreign investors, and institutional investors. The promoters, financial institutions, and institutional investors collectively have a quarter of the equity ownership in these firms, and in more than a third of the sample companies their ownership is greater than 25%.[1] Different classes of owners bring their own expertise in efficient management of the firm. However, it is also likely that their interests may not perfectly align with each other. These conflicting interests affect the decision-making in a firm in myriad ways.

Controlling shareholders are known to take decisions in the long-term interests of a firm.[2] In Indian context, these controlling shareholders are also the promoters, who also take up directorial responsibilities. These controlling shareholders are also known to pursue non-financial interests that may differ from maximising economic goals to preserve family control, reputation, harmony, succession etc., which constitute the family's socio-emotional wealth.[3] While external capital may allow the firms to reach long term growth, it may go against that family interests in preserving the socio-emotional wealth.[4] This paper proposes that the socio-emotional wealth of the controlling shareholders affect the probability of financial distress or bankruptcy, as it has direct implications on their control and strategic financial choices to be made by them.

Socio-emotional wealth is defined as the 'non-financial aspects of the firm that meet the family's affective needs, such as identity, the ability to exercise family influence, and the perpetuation of the family dynasty'.[5] This study considers controlling shareholders' behavioural aspects, such as the desire to maintain and perpetuate their control and preserve the socio-emotional wealth within the controlling shareholders. The socio-emotional needs to the controlling shareholders requires them to retain control of the firm. This is also reflected in the financing decisions made by such firms. Extant literature states that firms with high degree of controlling shareholder ownership are more likely to raise finance through debts, rather than part with equity.[6] This non-dilution entrenchment effect allows the promoters to retain control while realising the financing needs of the firm. However, this action also leads to a higher degree of bankruptcy risk. This high degree of debt also creates a governance issue, as when controlling shareholders take decisions detrimental to the health of the firm, while ensuring to protect their socioemotional endowment, the interests of the creditors are compromised.

Firms with high controlling shareholder ownership, like family firms, have been seen to take on a higher quantum of risks than non-family firms. In addition to this, this behaviour increases as the ownership percentage increases. Poletti-Hughes and Williams (2019) find that rather than driven by future growth prospects, these firms generally take on higher levels of risks to preserve their socio-emotional wealth.

Further, we also examine the effect of bank's monitoring through the appointment of the directors on the boards in mitigating the likelihood of bankruptcy or financial distress. The role of the banker on board is dual in nature. Bankers are expected to provide expertise.[7] When the appointee is a non-lender, her main objective is to provide expertise and certification of distressed firms. On the other hand, the lender appointee's primary role is that of monitoring.[8] Although the banker on board is expected to guide the executives to steer the firm clear of distress, it has been noted that their advice is not necessarily value-maximising.[9]

Additionally, it has been noted that the presence of a banker on board results in a higher likelihood of the firm going into financial distress.[10] The literature indicates that bankers fail to protect the interests of the residual claimants and are also unable to execute the primary functions that they are expected to deliver. However, Chauhan et al. (2018)[11] observe that bank appointed directors enhance access to bank and non-banking financial institution loans in India. In such cases, we examine if the bank appointed directors reduce the probability of distress by either effectively monitoring or directing to different avenues of funds in the likelihood of distress.

In this study, we examine how the three major owner stakeholders affect the probability of distress of the firm. We use the Prowess$_{dx}$ database of the Centre for Monitoring Indian Economy (CMIE) to test our hypotheses on Indian firms. We find that, contrary to our proposition, promoter ownership reduces the probability of default. This finding supports the stewardship hypothesis that rather than engaging in self-serving behaviour promoters work towards to reduce risk of the firm. The owners want to preserve the socio-emotional wealth for their heirs and hence try to reduce risks. We also find that institutional investors increase the risk of default. It is indicative that institutional investors may not necessarily guide the management towards improvement in efficiency. Interestingly, when we simultaneously test their effect on probability of default, we find that institutional investors' impact lose significance. We also test the impact bank appointed directors have on the probability of default and we have no significant effect. The results add to the literature on ownership and financial distress and provides evidence that opposes the notion that institutional investors bring efficient monitoring and expertise for the management with their investments.

The rest of the paper has been organised as - First, it reviews the existing literature and develops relevant hypotheses. It goes on to describe the data sample employed and the methodology for the empirical analysis. It then discusses the results, followed by the conclusion.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The literature on ownership and its relation to the risk of the firm has been primarily studied under the lens of agency theory. It states that the managers are more likely to be motivated by their private benefits and retention of control and position than to work towards value maximisation of the firm. However, in an emerging economy like India where the markets have not been fully developed and the legacy issues of the previous economic regimes, the context changes. The lack of institutional setup for managerial talent and financial assistance led to the growth of closely held family firms with high degree of control and ownership.

Jensen and Meckling (1976) have explained that self-interests and the opportunity to extract private benefits might affect the risk-taking behaviour. This behaviour is contingent upon the class of the ownership. Controlling shareholders, through their ownership, can control the cash flow rights and extract more benefits for themselves. A more concentrated ownership would allow the controlling shareholders to take on risky projects to increase their cash flow rights. E.J. Lee et al. (2018) find that if the ownership is large, the interests of the controlling shareholders align with the firm value maximisation. In such cases, the controlling shareholders are more prone to take up risky projects that would increase firm value.

Research has also found evidence that indicates that higher ownership leads to lesser risk taking. The rationale behind these arguments is that controlling shareholders would like to retain their wealth and pass it on to future generations as an inheritance. Hence, they would be more cautious in selecting projects. Secondly, they also want to increase the time period in which they can extract benefits out of the firm. To that end, the survival of the firm becomes paramount for them to ensure future cash flows. Thirdly, with higher investment in the company, a considerable chunk of shareholders' wealth gets captured in the firm. To protect their own interests, the controlling shareholders are more likely to opt for projects with lower risks (Su et al., 2016).

However, research also states that when creditors cannot monitor shareholders, the controlling shareholders can take risky projects if the benefits can accrue to them at the cost of the creditors. Outsiders' monitoring is generally imperfect and ex post. It has been seen that owners in these cases can increase the corporate risks. Extant research has also shown that when the ownership is highly controlled, as in the case of a family firm, in addition to passing on the wealth to the future generations, the horizons for investments increase manifold. In that case, these firms are able to take projects with longer durations, that are associated with higher risks, whereas other firms can only invest for shorter horizons. Gomez-Mejia et al. (2022)[12] find that socio-emotional wealth leads to higher extraction of private gains by the controlling families. It is also stated that families would take higher risks by investing in R&D under financial duress. In order to preserve their socioemotional wealth, such firms take on more risks rather than becoming cautious to conserve their wealth and allow the economic situation to tide over.

The behaviour exhibited by the socioemotional needs of the promoters, especially during hard times reflect a higher propensity to take on risks. The socioemotional aspect also leads these firms not to exit the market during financial distress and sustain for a longer period of time under distress.[13] Since firms with highly concentrated ownership take on higher risks to preserve socioemotional wealth and agree to take on performance hazard risk to safeguard their family wealth,[14] we hypothesise that:

Hypothesis 1*:* There is a significant relationship between controlling shareholdders' socioemotional wealth and the probability of financial distress

Institutional ownership is more inclined towards creating a steady stream of cash flows on their investments. Institutional owners also have the ability and access to monitor and control controlling shareholders' investment decisions. While controlling shareholders can opt for projects intended for firm value maximisation and engage in risk shifting through principal-principal agency conflict, institutional owners can restrain such decisions. The management disciplining view deems institutional owners to be monitors of the management actions. They are expected to reduce information asymmetry and agency conflict between the controlling shareholders and minority shareholders.[15]

This results in the selection of safer projects by the firm, even if it ends with suboptimal firm performance. Research has shown that firms controlled by banks have lower earnings volatility and poor performance (Weinstein and Yafeh, 1998). It emphasises the fact that institutional owners would restrict managers from opting for high-risk projects. Another factor that supports the argument is that with increased institutional ownership the cost of monitoring is justified on the part of institutional owners.

The institutional owners-controlled firms also exhibit lower volatility of earnings, which indicates investments in projects with lower risks. Pinkowitz and Williamson (2002) show that firms controlled by Japanese banks have held excessive cash reducing risk and performance. Institutional owners can also effectively monitor the management's actions and, hence, can control their risk-taking behaviour. Shleifer and Vishny (1986) exhibit that the free-rider problem concerning the monitoring of managers gets remedied with increased institutional ownership. Hence, we hypothesise that:

Hypothesis 2: There is a negative relationship between the ownership of institutional investors and the probability of financial distress.

The lack of private financial investors and underdeveloped markets also ensured that a large portion of the financing needs of the firm is fulfilled by the financial institutions like banks. While managers generally select high-risk projects to increase the value of the firm, the bank appointed directors take a more conservative view of the projects. The bank appointed directors come with a better understanding of financial matters due to their experience. Their presence on board help firms with access to their financial expertise and to markets (Y. S. Lee et al., 1999). This coupled with the fact that a position on board accords them superior information about the operations of the firms, they can carry out their advisory and monitoring function in a better way than if they just fulfilled the role of a creditor.[16] The volatility of stock returns of firms having a bank appointed director is also significantly less indicating a propensity to pick projects with lower risks (Jadiyappa, Joseph and Kumar, 2021).

The bank appointed director is also concerned with the longevity of the firm as they would like the firm to pay off their obligations to the bank in whole. This means that the bank appointed director is more likely to guide the management in selection of investment opportunities that have lower risks associated with them. The appointment on the board also provides the banker with a superior set of information of the investment opportunities than in a creditor's role.[17] This reduces the adverse selection problem, and their advice can help the management in reducing risks. It is also important to note that bank appoints directors when the quantum of borrowing is high or there are indications of financial distress on the firm.[18] The appointment in these cases is done to help alleviate the risk profile of the firm.

There is also the case that bank financing in India is led by public sector banks (PSBs). Since these employees of these PSBs are considered as public servants, they come under the scrutiny of various anti-corruption bodies. Compared to the risks associated with having a loan turning into a non-performing asset is not commensurate with the rewards, as the salary of mid-level and senior level bankers in PSBs is considerably lower than their private counterparts, these bankers are more likely to tread on the safer side and choose projects with lower risks.[19] Hence, we hypothesise that:

Hypothesis 3*:* There is a negative relationship between the presence of bank appointed director and the probability of financial distress.

INSTITUTIONAL CONTEXT OF THE STUDY

Indian firms present a rich scenario that motivates this study for the following reasons. Ownership is concentrated in Indian firms. Recent evidence suggests that the mean controlling shareholder ownership is 50% in India.[20] Controlling shareholders significantly influence a firm's financial decisions, including its dividend payments, share repurchases, choice of financing avenues, and investments.[21] In order to keep the financial status of the firm healthy, the promoters opt for recourses, including pledging of the shares. The financial institutions have the right to invoke the pledge in times of default, as evidenced by the recent cases of Dish TV and Ansal Housing's pledges invoked by Yes Bank and HDFC Bank, respectively. In the case of Dish TV, another promoter pledged his shares in April 2021, even when the lender invoked the previous pledge last year. This affirms the need for the promoter to retain control of the company even at the loss of the ownership.

DATA AND RESEARCH METHODOLOGY

Data Sample

The data for this study is collected from Prowess$_{dx}$, a database maintained by the CMIE. The data is sampled from 2001–2019 for all the firms listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The dataset begins in 2001 because the ownership classification data was unstructured and sparse before this year, and structured classification was mandated by the Securities and Exchange Board of India (SEBI) only in 2001. To mitigate the impact of outliers, continuous variables are winsorised at 1% and 99%.

Empirical Model and Variable Construction

The empirical design examines whether the higher socioemotional wealth of the owners/ firms affects the probability of financial distress of the firms. Further, we examine if the presence of bank appointed directors reduces the probability of distress. The baseline regression equation is a logistic regression model as follows –

$$\begin{aligned} \text{Logit } (P_{it}) = {} & \beta_0 + \beta_1 * CSO_{it} + \beta_2 * BAD_{it} + \beta_3 * CSO_{it} * BAD_{it} \\ & + \beta_4 * \textit{Firm Size}_{it} + \beta_5 * \textit{Tobin's Q}_{it} + \beta_6 * CapEx_{it} \\ & + \beta_7 * \Delta NWC_{it} + \beta_8 * \Delta STD_{it} + \beta_9 * BGdummy_{it} \\ & + \textit{Industry Fixed Effects} + \textit{Year Fixed Effects} + \varepsilon_{it} \end{aligned}$$

$$\#Eq.(1)$$

Where dependent variable, measures expected probability of distress for company *'i'* in the year *'t'*. The dependent variable is a dummy variable where it is coded 1 if the company is in financial distress, otherwise 0. Following (Mitchell & Walker, 2010), a firm's probability of bankruptcy or financial distress is calculated by employing Ohlson's O-Score (Ohlson, 1980). A firm with higher O-Score faces higher probability of bankruptcy. O – Score is calculated as:

$$\begin{aligned} \Theta_{it} = {} & -1.32 - 0.409 * \ln(\text{Total Assets}_{it}) + 6.03 * \frac{(\text{Total Liabilities})}{(\text{Total Assets})} \\ & - 1.43 * \frac{(\text{Working Capital})}{\text{Total Assets}} + 0.076 * \frac{(\text{Current Liabilities})}{(\text{Current Assets})} - 1.72 * X \\ & - 2.37 * \frac{(\text{Net Income})}{(\text{Total Assets})} - 1.83 * \frac{(\text{Fund from Operations})}{(\text{Total Liabilities})} + 0.285 * Y \\ & - 0.521 * \frac{\text{Net Income}_{it} - \text{Net Income}_{it-1}}{|\text{Net Income}_{it}| - |\text{Net Income}_{it-1}|} \end{aligned}$$

$$Eq.(2)$$

Where X = 1, if Total liabilities > Total Assets, 0 otherwise and
Y = 1 if a net loss for the last two years, 0 otherwise.

The firms are sorted by O – Score annually and divided into quintiles. The top and bottom quintiles are retained each year by dropping inner quartiles. The firm-year observations in the top quartile face a higher probability of distress and coded 1 ($P_{it} = 1$), while the bottom quartile firm-year observations are coded 0 ($P_{it} = 0$).

The variable of interest, controlling shareholder ownership (CSO_{it}), is calculated as the percentage of equity shares held by controlling shareholders/promoters to the total amount of outstanding shares in a firm. Influence over firm's strategic choices and associated socio-emotional wealth increases with increasing controlling shareholder ownership (Berrone et al., 2012). According to SEBI (ICDR) Regulations, 2018,[22] a promoter is defined as a person who has been named so in the draft offer document or offer document and who has control over the affairs of the issue directly or indirectly. Bank-appointed director (BAD_{it}) takes a value 1 for the firm whose board has at least one bank-appointed director, and 0 otherwise.

RESULTS AND DISCUSSION

Descriptive Statistics

The annual distribution of the mean ownership pattern (controlling shareholder ownership and institutional ownership) and average Ohlson score for each year and number of observations in each year is tabulated in Table 1. We find that on average, controlling shareholders hold an equity from 51.5% (Column 2 of Table 1). Further, we find that there is an increase in the ownership held by controlling shareholders, from 2001 to 2019, from 45% to 54%, a significant increase, leading to concentration of ownership. We further find that the institutional ownership on average ranges between 8.5 to 10% (Column 3 of Table 1). Column 4 represents an increase in average Ohlson score, a proxy for financial distress from 2001 to 2019, suggesting an increase in probability of failure of the firms in the sample.

We present descriptive statistics of these variables under consideration in Table 2. The mean Ohlson score, controlling shareholder ownership and institutional ownership is consistent with reported numbers in Table 1. The mean of the CSO_{it} in Indian firms is 52% and the median at 54%, which is similar to the numbers reported in Jindal & Seth (2019). This proportion of CSO_{it} is different from those observed in the US, UK, Italy, Korea, and China (Porta et al., 1999). Influence over firm's strategic choices and associated socio-emotional wealth increases with increasing controlling shareholder ownership (Berrone et al., 2012).

We further find that close to 12% of the observations in the sample have bank appointed directors. The descriptive statistics of the control variables are tabulated further. The mean firm size is 7.8, consistent with the range reported in Indian studies (Chauhan et al., 2016; Gupta & Bedi, 2020). The mean Tobin's Q of the firm is 2.1. Capex or capital expenditure is calculated as net fixed assets plus depreciation minus the previous year's net fixed assets plus depreciation, divided by total assets. Average ΔSTD (Short term debt) is close to 0, suggesting half the firms in the sample increased short term debt while other half of the sample might have reduced the short-term debt from the previous year. Similarly, we find that average ΔNWC is 0. Finally, 45% of the observations in the sample are affiliated to the business groups.

EMPIRICAL RESULTS

Effect of Ownership on Probability of Distress

Table 3 presents the estimation results following Eq. (1), presenting results of Hypothesis 1 and Hypothesis 2. The standard errors are clustered at the firm level. The coefficient of interest, β_1, (B-Beta) (Column 1, Table 3) is negative and significant at 1%, meaning that controlling shareholders reduce the probability of distress or default in Indian firms, supporting the claims in Hypothesis 1, that controlling shareholders have a significant influence on the probability of distress.

The specification in column 2 presents the results of Hypothesis 2 by examining the role of institutional investors on the probability of distress. We find that there is a positive and statistically significant relationship between institutional investor ownership and the probability of financial distress.

However, considering both CSO and IO together yields interesting results. We find that the probability of distress reduces with increasing controlling shareholder ownership, but the effect of institutional investors become statistically insignificant. While the reasons on why institutional investors does not reduce financial distress needs to be explored further, we find that in the presence of promoters or controlling shareholders, who are interested in the long-term interests of the firm, the positive correlation between institutional investors and probability of financial distress is insignificant.

The signs and significance of the control variables are consistent with the existing literature. We find that the probability of financial distress is lesser in smaller firms. Firms with higher growth opportunities (Tobin's Q) also have lesser probability of distress. Interestingly, there is also a negative correlation between firms investing in capital expenditure and probability of financial distress.

However, we find that there is a positive relationship between change in the short-term debt and the probability of financial distress. We understand that the firms facing the prospect of financial distress raise short term debt to survive before they find other sources of funds. This insight in not reported in the literature in India or other emerging economies, as far as we know. Next, there is a negative relationship between ΔNWC and probability of distress, suggesting that firms increasing their net working capital, to increase the short-term operations, do not fear or face any threat of financial distress. Finally, we find that business group affiliates face higher probability of distress, in comparison to standalone firms (non-group affiliates), which needs to be explored further.

Role of Bank Appointed Directors on Probability of Distress

Table 4 presents the results of the role of bank appointed directors on the probability of distress. Unlike the proposed hypothesis, we find that there is a positive relationship between the presence of bank appointed directors and the probability of financial distress in the Indian firms (Column 1 of Table 4). In Column 2, we also control for the role of ownership along with the bank appointed directors. Consistent with the results in Table 3, we observe that the controlling shareholders reduce the probability of distress, while institutional investors have no effect. But bank appointed directors still predict an increase in the probability of financial distress. This can be explained by the reverse causality, that perhaps, bank appointed directors on board are present only in firms where there is a probability of distress. Further specifications have to control for endogeneity to examine the relationship between bank appointed directors in Indian firms and the probability of financial distress.

In Column 3, as we examine the moderating role of bank appointed directors on relationship between controlling shareholders and probability of distress, we find that bank appointed directors do not make any difference in the presence of higher controlling shareholder ownership. This finding is contradictory to the expected findings, as we expect that bank appointed directors reduce the control and dominance of the promoters or concentrated owners and monitor the firm or reduce the likelihood of bankruptcy, by directing towards sources of funds, either through their banks or financial institutions or others. This result should be further examined after controlling for endogeneity, to conclude the role of bank appointed directors in India. If so, the channels through which bank appointed directors reduce or influence the probability of distress needs to be examined further.

CONCLUSION

Based on our understanding of the literature and positing it in the Indian context, we hypothesised that the firm's socioemotional wealth would significantly affect the probability of default. In a bid to retain control and preserve the wealth in terms of firm value, the controlling shareholders are likely to invest in riskier projects. They are also more likely to invest in riskier ventures and hold on to ownership for a more extended period, even in the face of financial duress. On the other hand, institutional owners bring in expertise and fulfil the monitoring role in firms. The management disciplining view suggests that they reduce information asymmetry between the shareholders and the managers which helps in better control of the management's actions. In Indian context, this Type I agency conflict gets transformed into a Type II agency conflict as the concentrated ownership and the propensity to put a member of the controlling family in the management provides fertile ground for the promoter family to extract benefits at the cost of firm value. Institutional owners can effectively restrict this behaviour and steer the management towards sound management practices, thereby, reducing the probability of financial distress. Bank appointed directors act as financial expert who can guide the management and provide their expertise on financing decisions for better financial management. Hence, we hypothesise that presence of bank appointed directors reduces the probability of financial distress.

Analysing a sample of 12,239 firm-year observations from 2001–2019, results suggest that higher controlling shareholder ownership reduces the probability of financial distress in the Indian firms, to preserve their socioemotional wealth. But contradictory to our expectations, we find that institutional investors increase the probability of financial distress in Indian firms. We also find that the bank appointed directors increase the probability of financial distress. The results provide a new perspective to the role of different ownership groups. The results show that the promoters are more likely to be conservative in their outlook as they try to preserve their socioemotional endowment. These results align with the stewardship theory which states that the rather than engaging self-serving behaviour, the promoters work towards the achieving the interests of the firm. The results also show that the institutional investors do not necessarily perform their monitoring function satisfactorily. It is expected that due to the higher stake of such investors in these businesses, they will be more inclined to guide the management in taking better business decisions. However, we find that it increases the probability of financial distress. We also find that presence of bank-appointed directors increases the probability of financial distress. However, banks generally appoint directors when they have a significant lending to the firm or if the firm's performance has been lagging. So, this result may also be driven by endogeneity. In further analyses, we will recognise appropriate empirical specifications to control for endogeneity, to arrive at unbiased estimate and nuanced understanding of the results.

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Table 1: Annual Trends

Financial Year	Mean Controlling Shareholding Ownership	Mean Institutional Ownership	Ohlson Score	Number of Firms
2001	45.01	15.69	1.45	68
2002	49.10	9.59	1.91	508
2003	49.64	9.17	1.73	536
2004	49.47	9.11	1.52	555
2005	49.30	8.71	1.26	594
2006	48.93	9.51	1.31	615
2007	49.43	9.70	1.14	619
2008	48.94	10.28	1.04	670
2009	51.12	9.64	1.52	702
2010	50.83	9.66	1.35	708
2011	51.67	9.39	1.57	746
2012	52.54	9.19	1.79	755
2013	53.34	9.00	2.01	750
2014	54.44	8.66	2.01	749

Financial Year	Mean Controlling Shareholding Ownership	Mean Institutional Ownership	Ohlson Score	Number of Firms
2015	53.70	9.15	2.24	733
2016	53.18	9.99	2.21	696
2017	51.91	10.29	2.40	715
2018	52.79	10.98	2.45	742
2019	53.52	10.57	2.41	755
Overall	**51.47**	**9.53**	**1.79**	**12216**

Table 2: Descriptive Statistics

Variable	Mean	Median	Minimum	Quartile 1	Quartile 3	Maximum	Std. Dev.
Ohlson Score	1.8	0.01	-2.8	-0.74	3.31	12	3.7
Controlling Shareholder Ownership	51	53	2	40	66.1	88	19
Institutional Ownership	9.6	3.3	0	0.03	16.1	75	13
Bank Appointed Director Ratio	0.12	0	0	0	0	1	0.33
Firm Size	7.8	8	4.4	6.04	9.53	11	2
Tobins Q	2.1	1.3	0.14	0.55	2.99	6.7	2
Capital Expenditure	0.02	0	-0.06	-0.02	0.03	0.18	0.06
Delta STD	0.01	0	-4.7	-0.02	0.04	1.3	0.15
Delta NWC	0	0	-0.39	0	0	0.17	0.01
BG Dummy	0.45	0	0	0	1	1	0.5

Table 3: Role of Ownership on the Probability of Distress

	Dependent variable:		
	Probability of Distress		
	(1)	(2)	(3)
Controlling Shareholder Ownership	**-0.010*****		**-0.010*****
	t = -7.964		**t = -7.247**
Institutional Ownership		**0.007*****	**0.001**
		t = 3.359	**t = 0.324**
Firm Size	**-0.513*****	**-0.545*****	**-0.516*****
	t = -35.707	**t = -31.693**	**t = -29.252**
Tobin's Q	**-0.183*****	**-0.202*****	**-0.184*****
	t = -15.384	**t = -16.849**	**t = -15.015**
CapEx	**-4.587*****	**-4.701*****	**-4.588*****
	t = -12.226	**t = -12.532**	**t = -12.226**
Delta STD	**2.038*****	**2.050*****	**2.038*****
	t = 11.226	**t = 11.325**	**t = 11.228**
Delta NWC	**-21.540*****	**-20.864*****	**-21.543*****
	t = -3.560	**t = -3.461**	**t = -3.559**
BGDummy	**0.204*****	**0.192*****	**0.204*****
	t = 4.165	**t = 3.932**	**t = 4.159**
Constant	4.378***	4.146***	4.387***
	t = 12.478	t = 11.818	t = 12.459
Ind FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	12,239	12,239	12,239

Note: *p<0.1; **p<0.05; ***p<0.01

Table 4: Role of Bank Appointed Director on the Probability of Distress

	Dependent variable:		
	Probability of Distress		
	(1)	(2)	(3)
Controlling Shareholder Ownership		-0.009^{***}	-0.010^{***}
		t = -6.767	t = -6.851
Institutional Ownership		0.0001	0.0004
		t = 0.049	t = 0.148
CSO * Bank Appointed Director			0.005
			t = 1.318
Bank Appointed Director	0.546^{***}	0.490^{***}	0.235
	t = 7.779	t = 6.952	t = 1.137
Firm Size	-0.529^{***}	-0.528^{***}	-0.528^{***}
	t = -35.623	t = -28.929	t = -28.919
Tobin's Q	-0.186^{***}	-0.176^{***}	-0.176^{***}
	t = -15.537	t = -14.079	t = -14.073
CapEx	-4.792^{***}	-4.675^{***}	-4.678^{***}
	t = -12.437	t = -12.102	t = -12.111
Delta STD	2.110^{***}	2.100^{***}	2.103^{***}
	t = 11.423	t = 11.313	t = 11.328
Delta NWC	-19.727^{***}	-20.553^{***}	-20.613^{***}
	t = -3.271	t = -3.370	t = -3.377
BGDummy	0.172^{***}	0.186^{***}	0.187^{***}
	t = 3.408	t = 3.687	t = 3.704
Constant	3.614^{***}	4.013^{***}	4.056^{***}
	t = 9.877	t = 10.801	t = 10.858
Ind FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	11,734	11,734	11,734

Note: $^{*}p<0.1$; $^{**}p<0.05$; $^{***}p<0.01$

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THE NEED TO IMPROVE GOVERNANCE STANDARDS FOR COMMITTEE OF CREDITORS AND RESOLUTION PROFESSIONALS TO SAFEGUARD THE GOAL OF CORPORATE RESCUE

— Priya Garg, Trusha Modi and Balapragatha M.

Executive Summary

The Insolvency and Bankruptcy Code, 2016 (IBC / Code) has undergone various amendments so far, and the Code continues to have a constantly evolving and rich judicial jurisprudence which is a testament to the judicial and legislative attempt to cope with the challenges in the effective implementation of the Code. The Preamble of the Code has corporate rescue as one of its objectives. However, in implementing the Code, we seem to have lost sight of this goal. In this context, this paper argues that the existing legal lacunae are jeopardising the end-goal of corporate rescue whereby this legal flaw primarily pertains to two main institutions responsible for carrying out the corporate insolvency process (CIRP) i.e., committee of creditors (CoC) and Resolution Professional (RP). We hope that this paper will make a significant contribution to the scholarly literature as, so far, there have been limited attempts to identify and analyse the importance of having concrete governance standards relating to the actors participating in CIRP, especially to achieve the target of corporate rescue. In the process, the research paper would address gaps in the existing literature regarding the requirement to have independence of RP and a code of conduct for CoC.

Keywords: Corporate Governance, Insolvency Governance, Committee of Creditors, Resolution Professional, Corporate Rescue.

INTRODUCTION

'The life of a company is as precious as that of a human. The Code provides a new lifeline to rescue a company when it experiences a serious threat to life.'

- Dr. M. S. Sahoo, Ex-Chairperson, IBBI[1]

Educomp Solutions Ltd. has been undergoing resolution under the Code for the last four years, making it one of the longest running cases.[2] The resolution plan, approved in 2018, was valued at ₹ 400 crore, out of which ₹ 75 crore of new capital was to be invested in the company to revive it and make it competitive.[3] After the resolution plan was approved in 2018 by over 75% majority voting, the International Finance Corporation and State Bank of India (SBI), the lead creditors, went to the National Company Law Tribunal (NCLT) to restrain the plan from being enforced and requested a second audit.[4] This pattern of delay in implementing the approved resolution plan by various stakeholders continued on one pretext or the other.[5] The inordinate delay in the resolution can be attributed to multiple factors. The relevant stakeholders complained that the lacklustre way the CoC acted eroded the company's value before the resolution process could be completed. The RP of the insolvent company had a conflict of interest, and the various advisors appointed by the RP were all in a complicit club.[6] After the Supreme Court judgment, a resolution seemed imminent, and SBI sold the company's most valuable assets at a grossly undervalued price.[7] A company that could have been rescued was led down the path of liquidity under the watch of the CoC and the RP. However, the interested parties were left with no recourse against the CoC and RP. The Code provides no provision for holding them accountable for failing to ensure value enhancement or preservation. Like this case, there are multiple instances where the Code's noble objective of reviving and rehabilitating companies has become a tool for harassment. In this paper, we seek to analyse the lacunae in the provisions relating to the functions and constitution of the CoC and the role of RP that obstructs the goal of corporate rescue.

The constantly evolving jurisprudence and continuous changes to the insolvency and bankruptcy laws are a testament to the judicial and legislative attempt to cope with the challenges of the Code.[8] The Code's preamble elaborates on the objectives of maximisation of the value of assets of corporate debtor (CD) and balancing the interest of all stakeholders. The key aim of the Code is to ensure that the CD keeps operating as a going concern during the insolvency resolution process. The Code, therefore, has adopted a cautious approach and provides that the market should first endeavour to rescue the CD and only liquidate the insolvent company after the attempts at rescue fail.[9] It also envisages corrective measures if the market wrongly proceeds to liquidate a viable CD.[10] However, after the recent introduction of the discussion paper by the Insolvency and Bankruptcy Board of India (IBBI) on issues related to the CIRP, concerns regarding the impartiality and self-interest motives of the two main actors, i.e., CoC and RP have been raised.[11] There is an imminent need to pay attention to the governance standards and behaviour of these two actors. In the implementation of the Code, we seem to have lost sight of the laudable objective of rescuing an entity which can be confirmed by the statistics released by the IBBI. Out of 3774 total CIRPs triggered since the Code's implementation, by the end of March 2020, only 221 have resulted in the rescue of the CD, while 914 cases have led to liquidation.[12] Additionally, by September 2021, 4708 cases of CIRP were commenced, out of which 14% of the resolution plans were approved as against 46% cases which led to commencement of liquidation.[13] It is apparent that an essential objective of corporate rescue is not met due to the existing lacunae in the provisions of the Code and its ineffective implementation.

In India, the corporate resolution process is creditor-driven as opposed to the USA, where a debtor-friendly approach is adopted.[14] This is because financial creditors (FCs) form the CoC, which decides the fate of the company by approving or rejecting the resolution plan.[15] Recently the Standing Committee on Finance, in its 32nd Report (Report of the Standing Committee) reiterated the urgent need of having a professional code of conduct for the CoC, which will define and circumscribe their decisions, as this will have a large implication for the efficacy of the Code. Similarly, RP role is vital to the efficient operation of CIRP as he/she is entrusted with the function of taking care of the CD's assets and day to day functioning of the CD's business. Given that an RP plays this important function in the resolution process, its independence and impartiality are of utmost significance.

This paper addresses this gap in the existing literature with respect to the independence of RP from other stakeholders and the lack of code of conduct for CoC, which hinders the CIRP process. At first, the paper examines the theoretical background to IBC and its relation to the goal of corporate rescue. The theoretical background helps us in understanding the importance of the objective of corporate rescue and the significance of the CoC and RP in achieving it. Following this, it analyses the institution of CoC and RP. Finally, it presents the conclusion. While we have endeavoured to provide recommendations to overcome the lacunae relating to CoC and RP, we acknowledge the limitation in providing substantive recommendations based on comparative analysis as the institutions involved in the different insolvency regimes are varied.

THEORETICAL BACKGROUND TO IBC AND THE GOAL OF CORPORATE RESCUE

An optimal insolvency regime should facilitate the rescue of viable businesses and the effective liquidation and exit of a non-viable entity.[16] The Code was introduced to create such a regime in India, and before this Code, the country's legal framework neither had an efficient rescue mechanism nor a satisfactory exit route for sick companies.[17] The Code offers a market-directed, time-bound mechanism to resolve insolvency or exit when needed.[18] The main objective of the Code includes providing a justified balance between interests of all the stakeholders of the company, maximising the value of assets of interested persons and providing a painless revival mechanism for entities.[19] By emphasising the need to maximise the value of the assets of the company and provide a revival mechanism, the Code emphasises the importance of the goal of corporate rescue. Corporate rescue is a major intervention necessary to avert the eventual failure of the company.[20] According to this goal, an acceptable outcome is avoidance of the ultimate demise of the company, which could be achieved either through sustainable company rescue or business rescue mechanisms.[21] Ideally, the goal of corporate rescue intends to achieve complete restoration of the company's financial position to its previous status with the workforce and general management intact.[22] This is often referred to as 'pure rescue'.[23] However, this objective could be difficult to achieve in practice and a more realistic outcome, often termed as 'business rescue', which is the sale of the business of the company undergoing insolvency process as a going concern sale or as a partial going concern sale.[24] For the purposes of this paper, the term corporate rescue would mean collective strategic rescue proceedings under the Code or other legal framework which are aimed at facilitating either the conservation of the distressed company or the rescue of its underlying business by selling it to a new buyer.[25] The Supreme Court in the *Swiss Ribbons* elaborated on the goal of the Code and observed that the preamble of the Code does not, in any manner, refer to liquidation, which is considered only as a last resort.[26]

The process of achieving value maximisation requires compulsory or voluntary risk-sharing and collectivisation amongst the stakeholders, mainly the creditors.[27] The Code provides an opportunity to all key stakeholders to participate in the insolvency proceedings and collectively assess the viability of the defaulting firm. While casting a duty on the CoC to maximise the value of assets, it also intends to balance the interest of all stakeholders.[28] This balancing of interest of all stakeholders can be achieved if the value of the CD's assets is maximised, and such maximisation can be attained through the 'collective' endeavour to revive the failing CD.[29] Thomas H. Jackson argues that creditors should prefer a collective process as opposed to a race to grab assets individually as it may often lead to the demise of the CD.[30] A collective process is considered superior as if it is left to the own whims of individual creditors, they will be motivated to act solely in their own interests, and the interest of the CD will be ridiculed. Therefore, the Code seeks to resolve this by preventing individual creditor action. The CoC functions elaborated in the Code place reliance on the creditor's bargain theory to maximise group welfare through collectivisation.[31]

In addition to the creditor's bargain theory, the Code's design is influenced by Korobkin's value-based theory, which emphasises the distributional impact of winding up of the company on other stakeholders who are not creditors and who may not have formal legal rights to the assets of the business.[32] In India, the Code adopts a CIRP operationalised through the RP and CoC. Therefore, the Code also places a duty on the two key players, the RP and the CoC, to ensure that the interest of all the stakeholders is met. Keeping these theories in mind, in the next section of the paper, we will discuss the issues with functions and power of CoC and RP that poses hurdles to the goal of corporate rescue.

ANALYSING THE INSTITUTION OF CoC AND RP

Institution of CoC and Its Goal to Promote Corporate Rescue by Better Governance Standards

In this section, we shall discuss the challenges and issues that arise in the constitution and functioning of the CoC, and we shall evaluate how it could hinder the objectives of the Code. In the first part we shall discuss the role of CoC and their importance in achieving the goal of corporate rescue. Understanding CoC's role would help us examine the issues with the constitution and appointment of CoC and how it could jeopardise the purpose of corporate rescue in the subsequent section. Further, in the next section we shall discuss the issues that arise due to the broad discretion bestowed on the CoC. Following the discussion on these challenges and lacunas, we shall scrutinise in final section the efficacy of the proposed code of conduct for CoC in the IBBI discussion paper to revive the goals of corporate rescue, and we will suggest the potential changes that could be made to the current regime.

Explaining the institution of CoC

The CoC is formed by the Interim Resolution Professional (IRP) once the CIRP is initiated against a CD. They are the supreme decision-making body in the CIRP under the Code.[33] Section 21(2) of the Code, which provides for the composition of the CoC, states that the CoC shall comprise all the FCs of the CD. Section 3(10) of the Code defines a creditor as any person to whom a debt is owed, and it provides that the term includes an FC and an operational creditor (OC). FCs are those whose relationship with the entity is based on a purely financial contract, such as a loan or debt security. OCs are those whose liability from the entity is based on a transaction for the operation of the business.[34] The Code also envisages circumstances where a creditor has both a financial transaction and an operational transaction with the company.[35] In such a case, the creditor can be considered an OC to the extent of the operational debt and an FC to the extent of the financial debt.[36] Another crucial difference between both types of creditors is that, while the FC can vote in a CoC, an OC cannot. According to sections 5(28) and 24(6) of the Code, the voting share in the CoC bears a relation to a financial debt owed to the CD. Keeping in mind who constitutes the CoC, it is essential to understand the objectives the

CoC must achieve. The Code empowers creditors who are part of the CoC to rescue a company when experiencing a severe threat to its life.[37] As a result, the CoC plays a crucial role in achieving the goal of corporate rescue. For this purpose, the Code provides the CoC with a '*Trishul*': (a) the CoC can take or cause a haircut of any amount to any or all stakeholders for rescuing the company; (b) it can seek the best resolution from the market, and (c) the resolution plan can provide for any measure that rescues the company.[38] The CoC powers also include authority to change management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of the organisation, business model, ownership, or balance sheet; strategies of turn-around, buy-out, merger, amalgamation, acquisition, or takeover.[39] While the RP manages the day-to-day affairs of the CD, it is the CoC who has been bestowed with the authority and duty to make decisions on the crucial matter which are critical for the existence of the CD.[40] The CoC would have to determine the viability of the CD's business, examine the feasibility of the future business, the cost and expenses that would be involved and subsequently, should either proceed with the resolution process, including the decision to extend the timeline or decide to immediately liquidate the CD when it is convinced that the resolution process would fail.[41] Further, an application for withdrawal of the insolvency application after its admission can be made by the applicant only after 90% of creditors of the CoC approve it.[42] The decisions of the SC in *ArcelorMittal India Private Limited v. Satish Kumar Gupta and Others*[43] and *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India*[44] place importance on the role and responsibility of the CoC in ensuring that the CD exists as a going concern and liquidation of the company is always considered only as a last resort. The main goal of the Code to maximise value through a sustained resolution, which is closely linked to the pursuit of corporate rescue, requires the adoption of strategies that are much beyond the restructuring of liabilities. This would need tremendous commercial dexterity and acumen on the part of the CoC. The pain or gain those results from the resolution of the CD must be shared by all stakeholders with fairness and equity, and therefore, the CoC must apply the highest standard, duty of care, follow due process, ensure fairness and be transparent. Given the wide powers bestowed in the hands of the CoC, it is relevant to discuss the fairness and appropriateness of decisions taken by them in a CIRP.

In the next section, we shall discuss the various challenges and issues that exist with the composition and powers of CoC that could potentially pose obstacles to CIRP objective while achieving corporate rescue.

Issues in constitution and appointment of CoC

Many have raised the concern that the functioning of the CoCs in an unregulated environment could severely hinder the objectives of the Code.[45] In some cases, the Liquidator was coerced to liquidate the insolvent company even when the entity was a 'going concern'.[46] Appointment of CoC without conferring the power to make final decisions has resulted in delays and has subsequently resulted in the depletion of value of assets.[47] Tribunals have also pointed out that the participation of related party FCs in the CIRP process could be fatal for the existence of the CD.[48] Under this section, we shall analyse two main challenges – (a) the issues that arise due to participation of inadequately authorised representatives in CoC and (b) the hindrances caused as a result of the participation of related party FCs in the CIRP.

(a) Participation of inadequately authorised representatives in CoC

The CoC, which has been constituted 'to decide', can 'not decide' and remain indeterminate. The CoC, as the driver, is expected to steer the wheel and decide on many matters pertaining to the CD under CIRP. Given the stringent timelines that the Code propounds, there cannot be any scope for delay in the decision-making process. In most cases, the CoC often consists of financial institutions and banks, who direct their representatives to attend the meetings held by the RP[49] It has been noted that in many circumstances, these representatives who attend the CoCs meeting on behalf of creditors of the insolvent company, are merely note-makers or listeners and don't have the authority to take part in adequate deliberations in the meetings.[50] Participation of these representatives without adequate authorisation delays the CIRP, and the entire objective of CoC meetings stands defeated. In the matter of *SBJ Exports & Mfg. Pvt. Ltd. v. B.C.C. Fuba India Ltd,*[51] members of the CoC, nominated representatives without conferring upon them the authority to decide on the spot. In many other cases, the tribunal has criticised the CoC for conducting meetings without attendance from their competent authorities to make final decisions. Most of these nominated representatives fall back to their seniors for approval which delays the time-bound procedure envisaged by the Code.[52] The delay in decision making results in depletion of value which is sought to be contained. This directly affects the objective of value maximisation, which subsequently hurdles the goal of corporate rescue.

Such delay in process should be appropriately regulated, and it should be stipulated that only competent members who are authorised to take decisions are nominated to the CoC. The IBBI circular dated August 10, 2018 directed the RPs to ensure the attendees in CoC meetings are decision-makers themselves.[53] However, as the circular places onus on the RP to ensure that authorised representatives attend the meetings, the CoC still has levy to convolute the requirement.

(b) Participation of related party FCs in the CIRP process

The concept of related party transactions, which are transactions entered into by a company with its related parties, and the treatment of such transactions is a highly regulated aspect of corporate governance. Especially in the context of avoidance transactions with a company facing an imminent threat or likelihood of insolvency proceedings, their relevance gains significance. From the point of view of CIRP, avoidance transactions are those transactions whose outcomes the RP seek to avoid as they erode the value of the company and usually take place during the 'twilight period',[54] that is, the period where the management of the company is presumed to be aware of the possibility of commencement of insolvency proceedings. There is a number of transactions that can be categorised as avoidance transactions, including undervalued transactions, the extension of undue preference to a particular creditor over others, those entered with the intent to defraud creditors and extortionate transactions.[55] The possibility of avoidance of transaction with a related party raises more concern than with an unrelated party as the former possesses superior information relating to the company's financial affairs, which could be used to divert assets of the said entity away from its creditors and stakeholders. Therefore, their participation in the CoC's decision-making process would prejudice the resolution prospects and subsequently affect the goal of corporate rescue and subsequently affect the pursuit of corporate rescue.[56] As the effects of avoidance transactions by related parties are not ostensibly identifiable, it is significant to have a robust and well-developed legal framework for identifying and reversing the effects of it on all the stakeholders.

To reduce the possibility of participation of related parties in CoC, it is necessary to provide an unambiguous and precise definition as to who can be categorised as a related party in relation to a CD. Sections 5(24) and 5(24A) of the Code defines a related party in relation to a CD and to an individual, respectively. The related parties could include a director, key managerial personnel, limited liability partnership (LLP), public company, body corporate, and CD's primary adviser. It also includes persons having more than 20% of voting rights and those who control the composition of the board of directors. Since the Code attempts to balance the interests of all stakeholders and seeks to ensure that few stakeholders don't benefit at the expense of others, according to section 21 of the Code, related-party FCs are disqualified from being represented, participating or voting in the CoC.[57] The intention behind denying the entry of related parties of the CD from participating in the CoC is to suppress the conflict of interest, which could influence the outcome of the CIRP in a negative way and could pose hurdles to the path to achieve the goal of corporate rescue. The UNCITRAL Legislative Guide on Insolvency law has also recommended the disqualification of related parties.[58]

Further, in *J. R. Agro Industries Private Limited v. Oils Private Limited,*[59] NCLT ruled that under the legislative UNCITRAL guide, the dues of related parties shall not overshadow the OCs's claims, stipulated in terms of loans. Thereby, the tribunal prioritised the dues of unsecured creditors over related parties, disassociating the related party from the participation of CoC and their influence over the resolution plan. This is in line with the prevailing practice in the UK and US, too, where the claims of OCs rank above the claim of related party claim.[60]

Courts and tribunals have dealt extensively with the issue of participation of related parties in CoC. In the case of *Sushant and anr v. JD Aneja Edibles,*[61] the NCLT held that the nature of transactions between the CD and related parties could not be considered the same as the transaction with a CD and an outsider. To ensure that there is no abuse of process under the Code and to reduce the adverse effect on genuine stakeholders, the related parties were excluded from the CoC. While the Code explicitly bars the inclusion of a related party in the CoC, it doesn't expound on the status of an FC who ceases to exist as a related party and whether such creditors can be part of the CoC. To take advantage of this lacuna, some related party creditors assign their debts to a third party with an intention to circumvent the disability imposed under the first proviso to section 21(2) of the Code.[62] In the matter of *Fortune Pharma Private Limited,*[63] the related parties of the CD, through multiple assignment agreements, transferred their debts to a non-related third party with the aim to reduce the voting share of SBI, the applicant, from 100% to 50%. The Court noting the meticulous planning and malafide intention of the promoters/ directors of the CD decided that the related party cannot suddenly become a non-related party by assigning its debt to another party with no concrete reason for acceptance of this debt by the other party. Further, the Supreme Court in *Phoenix ARC Pvt. Ltd. v. Spade Financial Services Limited*[64] clarified its view on the exclusion of related parties of the CD and examined the legislative intent behind the first proviso of section 21(2) of the Code. There were multiple collusive arrangements, and there existed extensive history demonstrating interrelationship among the parties. The boards of directors were acting under the influence of a common set of individuals who had 'deeply entangled' interrelationships.[65] The Court didn't entertain the entities as FCs, as the debt was considered as merely an eye-wash, arising out of 'sham and collusive transactions'.[66] It is important to note that the related party was no longer related to the CD at the time of initiation of CIRP. Therefore, the Court had to deal with the issue of whether the relatedness of the parties could even have existed in the past or whether they must continue *in praesenti.* The Court had to examine the first proviso to section 21(2) of the Code, which provides that '*a FC [...] if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors*'. Moving away from the literal interpretation, the Court emphasised the purpose and objective of the Code to note that collusive transactions are anathema to the philosophy of the Code. The Court pointed out that the FC, who *in praesenti* is not a related party, would not be barred from being a member of the CoC. However, suppose a related party FC assigns its debts or ceases to become a related party in a business capacity, with the only intention to participate in the CoC and ridicule the CIRP. In that case, they should be debarred from participation to uphold the object and purpose of the first proviso to section 21(2) of the Code.[67] The Court rightly held that no party should be allowed to take advantage of a legislative benefit generated through its own wrongdoing.[68] However, the usage of collusion or sham as yardsticks to deny participation in CoC could create challenges. These standards would bestow a tremendous amount of discretion on the courts and tribunals, and the absence of clear guidance on the nature of collusive or sham transactions that could debar persons from being treated as FC could lead to an increase in litigation to clarify the question of who can be treated FC.[69]

Issues with a wide discretion of CoC

Time and again, tribunals and courts have reiterated the principle of primacy of commercial wisdom of the CoC.[70] Multiple judicial precedents reiterate the unfettered power to exercise commercial wisdom by CoC.[71] The purview of judicial review in approving the resolution plan shall only be limited to the grounds stated in the provisions of the Code itself, that is, in case of the NCLT, section 30(2) of the Code and in case of the NCLT, section 61(3) of the Code. Courts have further noted that it was a conscious decision of the legislature to not provide for any other grounds than the ones already mentioned in sections 30(2) and 61(3) in order to challenge the commercial wisdom of the CoC before the Adjudicating Authority (AA).[72] Thus, the AA lacks jurisdiction to inverse the commercial wisdom of the dissenting FCs. Even when the courts intervene, they are restrained from going into the merits of the decision taken by the CoC using their commercial wisdom, but the objectives of the Code such as maximisation of value of assets of the CD etc., if not taken into consideration, the AA can review the said decision.[73] The scope of section 30(2)(e) of the Code was explained by the Court to include the following, which must be strictly ensured by the CoC when a CD is being resolved under the Code: (a) the CD should continue as a going concern during the resolution process (b) ensure maximisation of the value of the assets of the CD; (c) interests of all stakeholders must be balanced.[74] The decision taken by the CoC based on ground realities binds all stakeholders.[75] The Code envisages an exalted status for the CoC in commercial decision making, and the sacrosanct cast around the wisdom of the CoC creates catena of challenges. Although this creditor-in-control approach is in line with the scheme of the Code, it has been subject to rampant misuse in the recent past resulting in a delay in completion of the CIRP and disregard of the interest of other stakeholders of the CD.[76] A proper governance framework for the functions of the CoC became significant, given the primacy of 'commercial wisdom of CoC'[77] in deciding the fate of the CD undergoing CIRP. In light of this, though multiple scholars and tribunals have pointed out the issues with the functions of CoC under the Code, there is a lack of literature on how these challenges impede the goal of corporate rescue. In this section, we examine how the lack of governance framework against the functions of CoC affects the goal of corporate rescue. Further, we would analyse whether the primacy of the commercial wisdom of CoC has undermined the goals of corporate rescue and whether there existed a need to subject the commercial wisdom of CoC to judicial wisdom. We will be discussing the issue with large haircuts, which is a result of the misuse of commercial wisdom of CoC and we will also be examining various instances where the supremacy of the commercial wisdom of CoC has been abused to serve the self-interest of certain key players.

Issue with Large Haircuts

One of the instances where the commercial wisdom of the CoC was brought into question was the acceptance of large haircuts on the company's total dues by the CoC. It is of pertinence that a normal amount of haircut is necessary for the process of insolvency. However, the problem lies with the large amounts of haircuts coupled with its frequency and a remarkable reduction in the amount of recovery post these haircuts.[78] The Report of the Standing Committee has pointed out this issue while stating that the FCs have been taking disproportionately large and unsustainable haircuts.[79] It was seen in one case that the financial lenders like public and private sector banks, non-banking financial institutions, and other financial lenders to the company had taken a haircut of ₹ 3.22 lakh crore approximately, or 61.22% of the admitted claims while undergoing the CIRP.[80] The haircuts on the claims have thus arisen from an average of 55% in previous years to 60% in the financial year 2020-2021.[81] The first quarter witnessed haircuts of around 74% against the claims made by lenders from the defaulters.[82] IBBI data provides that exorbitant 'total shaves' which exceed 90% of the total dues have also been accepted by the creditors.[83] Some of these include Deccan Chronicle (95%), Infra (88%), Ushdev International

(94%), Videocon Industries (95.85%), Siva Industries (93.25%) and Zion Steel (99%).[84] At many times the evaluation matrix adopted by the CoC delineates from the objectives of the Code by focusing more on recovery than revival. Further, according to the survey, even though approximately 25% of the companies had a resolution plan, they were still liquidated due to non-approval of the resolution plan by CoC on grounds like low recovery rate. It is apparent that in most circumstances, the CoCs focus on the upfront payment and hence tends towards rejection of resolution plan where the haircut is high. Additionally, even though the Code promises a time-bound resolution that would complete within 330 days, in many circumstances, the timeline gets extended indefinitely.[85] The Code in the hands of stakeholders should act as a tool to be used in the proper case at the appropriate time in the right way. The CoC should use its commercial wisdom to deploy this tool in the early days of stress when the value of the firm is primarily intact and complete the process swiftly before its value deteriorates. This would minimise the possibility of liquidation or even avoid haircuts in the resolution plan. The ecosystem created by the CoC should facilitate clawback of value lost in avoidance transactions, and all participants must play by the rule book. Even the manner of computation of haircut must change

Instances of Misuse of Commercial Wisdom

In many instances, the vitality of commercial wisdom of the CoC has been questioned. In the case of the *Bank of Baroda,*[86] the resolution plan of the resolution applicant was rejected by the AA as it was merely used as a ploy to gain control of the CD by the very person who had pushed the CD into insolvency. While rejecting an appeal by an FC in the matter, the NCLAT observed that, '*this in itself raises eyebrows. This is further compounded by approval of the Restructuring Plan camouflaged as Resolution Plan emanating from an ineligible person, which renders the role of the Committee of Creditors questionable. Such circumstances justify the raising of inference of complicit*'. It rendered CoC's functionality doubtful when the restructuring plan was approved camouflaged as a resolution plan emerging from such an ineligible person.[87] In another case, the absconding and section 29A ineligible promoters attempted to take over the company in the guise of one time settlement, and 90.32% vote share of CoC approved it.[88] The NCLT commented that such an act '*can never be treated as an act of commercial wisdom*'.[89] In the CIRP of *Bhushan Power & Steel Ltd,*[90] illegal fees were paid by the RP to the lender's legal counsel of about ₹ 12 crore and the same was included in the insolvency resolution cost. This act of the CoC and the RP indicates deliberate planning for contravening the law. This inclusion was clearly in contravention of the IBBI's circular dated June 12, 2018, which clearly states that insolvency resolution process costs shall not include any legal fee paid to the legal counsel of the lenders/creditors.[91] The NCLT noted that the RP and CoC deliberately planned to contravene the law.

In the CIRP of *Varrsana Ispat Limited,*[92] even when the company was a going concern and a scheme under section 230 of the Companies Act, 2013 was under consideration, the Liquidator distributed ₹ 26 crore to FCs under their pressure. Such acts directly jeopardise the goal of corporate rescue. In *STCI Finance Ltd. through Subash Chandra Modi v. Parinee Developers Private Limited,*[93] while dismissing the application of RP for withdrawal of CIRP, the tribunal made observations against CoC for their conduct in postponing the issuance of Form G and expression of interest (EoI) continuously ten times without obtaining approval for the same from the AA. Many stakeholders have raised concerns regarding this non-compliance with the provisions of the Code and contravention of the goal of corporate rescue under the defence of the superiority of commercial wisdom. As the conduct and decision making of the CoC is not subject to any regulations, instructions and guidelines currently have raised the need for the introduction of a code of conduct for the CoC. The need was echoed in the Report of the Standing Committee who have also recommended the introduction of a code of conduct for the CoC 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'.*[94]

The need for a code of conduct and critique of the proposed code of conduct by IBBI

A code of conduct for the CoC would ensure transparency and avoid ambiguity. Internationally too, there are practices that subject CoC to certain rules and regulations for their conduct in the process. In the UK, the Association of Business Recovery Professionals, in conjunction with the Recognised Professional Bodies, has provided guidance on what might be expected of CoC.[95] Under the US regime, section 1102 of the US Code places the responsibility of interest of those represented by the committee, but not appointed on it, on the members of the CoC.[96] As the decisions of the CoC impact the life of the firm, the possibility of it being rescued and consequently its stakeholders, it needs to be fair and transparent in its decisions. The code of conduct would promote transparency in the working of the CoC and make participating members accountable for their actions during the process. It will strengthen collective action, which, as discussed before, is a fundamental principle underlying the Code.

To overcome the issues with the functioning of the CoC, the IBBI's discussion paper recommends establishing a code of conduct for CoCs that will raise their accountability and duty to guarantee that CoCs operate transparently. According to the IBBI's draft code of conduct, which is included in the IBBI discussion paper, a member of the CoC must maintain integrity in performing their roles and functions under the IBC, not misrepresent any facts or situations, and refrain from participating in any activity that is detrimental to the Code's objectives, exercise objectivity in exercising decisions, and disclose details of any co-operation. This is a welcome move, and however, if the code of conduct is included in the Code or the CIRP Regulations, it would provide additional ground for judicial review as it would be read as a 'law'. Few terms used in the Code of conduct such as 'maintain integrity' (clause a), 'maintain objectivity while making decisions' (clause c), 'ensure that the decision making is free from any fear, bias, favour or coercion' (clause j), etc.[97] are vague and uncertain, it can be subjected to a wide array of interpretations. This could potentially raise the number of litigations on process related issues and further slow down the CIRP. As a result, the proposed code of conduct in its present form would undermine the established principle of commercial wisdom.

Some illustrative recommendations relating to the institution of CoC

In this part, we have discussed two key issues with the CoC under the current regime. Firstly, in their constitution and appointment and secondly, the issues caused due to the misuse of the wide powers bestowed in their hands.

Firstly, regarding the composition and appointment of CoC, the existence due to the presence of unauthorised representatives causes a delay in the CIRP. Such delay in process should be appropriately regulated, and it should be stipulated that only competent members who are authorised to take decisions are nominated to the CoC. It would be helpful to mandate compliance by writing, perhaps as a part of the notice calling to the CoC meetings, where the creditors pre-approve the representative and bestow them with sufficient authority to make decisions. Later we dealt with the challenges arising from the participation of related party FCs of the CD in the CoC's decision-making process. While the default rule under the first proviso to section 21(2) of the Code is that only those FCs that are related parties *in praesenti* would be debarred from the CoC, those related party FCs that cease to be related parties to circumvent the exclusion under the first proviso to section 21(2), should also be strictly considered as being covered by the exclusion thereunder. While the Supreme Court in *Phoenix Arc* has clarified this position, further guidance on the nature of collusive or sham transactions that could disentitle persons to be treated as FCs should be provided.

Secondly, with regards to the issues caused due to the misuse of the wide powers bestowed in their hands, we examined the proposed code of conduct by IBBI. While the suggested code of conduct is a welcome move, if it is introduced in its present form, it could cause a delay in the CIRP. Alternatively, the general regulations by the Reserve Bank of India or the Securities and Exchange Board of India on the functions of the CoC could be extended and adapted to the insolvency proceedings as well. As these regulations wouldn't be considered as 'law' for the purposes of sections 30(2) and 61(3) of the Code, it won't lead to delay in the CIRP and at the same time could deter the CoC from adopting techniques that harm the goal of corporate rescue. This approach would also align with the inter-regulatory and coordination-based mechanism that the Ministry of Finance would like to adopt.[98] Further, to protect the interest of the stakeholders who are part of the CoC, a consultation process where the plan is placed before such stakeholders before it is submitted for NCLT's approval can be included. Further, to deal with the issue of excessive haircuts, justified under the defence of supremacy of commercial wisdom of CoC, as a maximum haircut limit for the resolution plan can be set. Regulation 35 of the CIRP Regulations provides the determination of the fair value and liquidation value of the CD. The maximum limit of haircuts can be according to these values decided under the said regulation. While some might argue that setting a maximum limit to the haircut could lead to infringement of the commercial wisdom of the creditors, it should be kept in mind that the unfettered exercise of commercial wisdom by the CoC which is prejudicial to the interests of other important stakeholders and the goal of corporate rescue, is also not in line with the objectives of the Code. Therefore, regulation of the discretion of the CoC becomes essential.

Having discussed the institution of CoC and ensuring a code of conduct to safeguard the goal of corporate rescue, in the next section, we discuss the institution of RP and its role in the CIRP process. The lacunas in laws relating to governance standards for RP that jeopardise the goal of corporate rescue is explored in the next part.

Institution of Resolution Professional And Its Role In Promoting the Goal of Corporate Rescue

This part of the paper explains the institution of RP in leading the CIRP and the lacunas in the law associated with governance for RP during CIRP. It deals with the independence criteria for RP *vis-à-vis* other stakeholders and argues that there is a need for a proper governance framework to govern the conduct of an RP, which jeopardises the role of corporate rescue. The subsequent sub-section also provides suggestions that could be implemented.

Explaining the Institution of RP

Once the insolvency proceedings kick in, the current board is replaced by an entity known as RP or IRP as the case may be. RP is entrusted with the management of the company. His role is to make every effort to manage the CD as a going concern and preserve the value of the property of CD.[99] To discharge this role, the Code endows him with various powers. This includes the authority to enter into a contract, amend or modify existing contracts entered before CIRP, raise interim finance, issue instructions to personnel, appoint accountants, legal or other professionals.[100] However, it is pertinent to note that such powers provided to RP are not unfettered and are subject to the authority of CoC. For instance, section 28 of the Code lists out acts of RP that shall be conducted with the prior approval of CoC, thus limiting RP's power.[101] Moreover, there is no provision that ensures the independence of RP from CoC and resolution applicants. The Code has unequivocally emphasised the need for an RP to be appropriately qualified and have the requisite knowledge, experience and personal qualities and has not provided appropriate framework for their governance.

Additionally, there exists a code of conduct that governs an RP, i.e., Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 (IP Regulations), which provides for disclosure of conflict of interest. However, the regulations are silent on the breach of it. Therefore, it becomes essential to analyse the standards and code of conduct that govern an RP so that they act in the best interests of all stakeholders and their decisions are free from external influence and bias.[102]

Independence and Impartiality of RP vis-à-vis other stakeholders

In the following section we argue that the external influence on the decisions of an RP is leading to bias and therefore, RP is not making independent decisions as envisaged by the Code. This is creating a hindrance in achieving the goal of corporate rescue. Subsequently, the lack of criteria for independence between the RP and resolution applicant is discussed. Further,it is argued that in contrast toprevious two sub-sections , the Code has overemphasised regarding the independence between RP and the CD.

RP and CoC

The code of conduct for Insolvency Professionals (IPs) under schedule 1, regulation 5 states that *'the Insolvency Resolution Professional must maintain complete independence in his professional relationships and should conduct the CIRP process, independent of external influences'*.[103] Therefore, RP should be a person who is independent and impartial. However, the current Code does not provide for such practices that bars the external influence of CoC exercised on RP as they function under the directions of CoC and also require prior approval for certain acts from the CoC.[104] RP, who controls the company's management and exercises a supervisory role to the executive management of the CD, needs to act in a manner that leads to the revival of the company. RP and CoC, the two main pillars in the CIRP process having different functions need to be independent of each other. This is required for a bias-free, impartial resolution process so that the goal of corporate rescue is safeguarded, as a process filled with prejudices and partiality will discourage prospective resolution applicants from submitting their bids. Further, it has been illustrated that there have been several cases where the RP has acted contrary to the Code's provisions due to CoC's influence. This has turned the CIRP into a mechanism that benefits only the creditors instead of all stakeholders.[105]

(a) External influence of CoC on RP's decision

A better resolution plan was discared because of the external influence on RP by the CoC in the case of *Binani Cements Ltd.* (Binani Cements).[106] The NCLT reprimanded RP for acting as a puppet of the CoC without exercising their obeisance during the CIRP process. In this case, the insolvency process was triggered by the FC's. The bidding battle was between UltraTech Cement Ltd. (UltraTech) and Dalmia Bharat Ltd. (Dalmia). The latter triumphed in the initial bidding. However, UltraTech, before the approval of Dalmia's resolution plan by CoC, which was not placed before the AA at all, submitted a revised bid, higher than its counterpart. UltraTech's resolution plan was better and allowed for the value maximisation of the assets of Binani cements and balanced the interest of all the stakeholders. The CoC, however, did not consider the revised offer of UltraTech, which was submitted before the CIRP duration expired, even though it is within the power of the CoC to consider revised offers. The CIRP was not conducted in a transparent manner, and the very spirit and object of the Code, i.e., maximisation of value of assets of CD, was compromised. The NCLT held that the RP's conduct violated IP Regulations as they have the responsibility to take independent decisions. RP has not taken any independent determination of his own for placing the plans before the CoC.[107] On the contrary, RP favoured the people who appointed them, i.e., had allegiance towards a few FCs. Therefore, there existed an undue influence on him by the CoC.

A comparison can be drawn for the independent criteria between the RP and independent directors of a company. An independent director who is not a related party is appointed to resolve the conflict of interest between the shareholder and managers of the company and ensure transparency and accountability in the company's day-to-day affairs.[108] Similarly, core principles of CIRP demand that the RP's decisions are free from doubts about any conflict, real or perceived, during the CIRP. They are the 'conscience keepers' who should guide the company towards its rescue independently from any external influence. However, the importance of RP to be a person independent without any conflict of interest with the CoC and resolution applicant has been neglected, which has created various problems to the goal of corporate rescue. There is an unmistakable need for ethical integrity from the RP during the CIRP process. Therefore, it is of utmost importance in order to have confidence in the insolvency regime, the RP should be a person who is of independent character. Also, another comparison exists between the acts committed by an RP in Binani cements case to that of the directors of a company failing to keep the company's best interests first, in their allegiance to be loyal to the shareholders who appointed them.[109] Since the RP takes over management and all the powers of the board of directors of the company stands suspended, their role needs to be similar to that of the director of the CD. They owe a fiduciary duty towards the company. The influence of CoC on RP is enormous which has often resulted in compromise of the company's best interests.

As noted above, similar concerns with respect to the conduct of RP were raised in many cases. In the case of *Gitanjali Gems Limited*,[110] there was a prior understanding between the IRP/RP and FC, that upon IRP/RP's appointment, the IRP/RP shall appoint a particular entity, where the fee of the entity was 20 times more than the fee of IRP/RP. Such acts harm the interests of the CD and other stakeholders of the company. As noted before, in the case of *Bhushan Power & Steel Ltd.*,[111] the CoC and RP were grouped to pay a fee of ₹ 120 million for services of a legal counsel that was rendered during the insolvency procedure. In the case of *Ram Dev International Limited*,[112] the Court stated that an RP could be a person related to the FCs as the only bar provided by the Code for appointment of an RP is there should be no disciplinary proceeding pending against the proposed RP. This case brought about an amendment to the Code, where according to regulation 8 of schedule 1, '*RP need to disclose the existence of any pecuniary or personal relationship, either directly or indirectly, with any stakeholders*'.[113] Despite such disclosure's requirement provided by the Code, RP can be replaced only by CoC by passing a resolution under section 22 and section 27 of the Code with a 66% majority. Therefore, the majority shareholder can appoint a non-independent RP, rendering the prescribed disclosure meaningless, and the apprehension of independence of RP becomes irredeemable.

Moreover, in the case of *M/s. Metenere Ltd*,[114] the IRP, was an ex-employee of an FC who was permitted to act as IRP because of the absence of any provision to the contrary. However, the Court, in this case, observed the issue of bias and impartiality of RP. The crux of conducting a successful CIRP is the impartiality and independence of RP. Therefore, it becomes pertinent to address this issue of autonomy vis-à-vis other stakeholders at the outset, as merely disclosing conflict of interest may not be of much consequence. Moreover, the implementation and breach of such Code is questionable, as illustrated by the above case laws.

(b) Limited Scope of judicial review in RP's appointment

In furtherance of the above points, the scope of judicial review in the appointment of RP is limited. The AA has to consider the name of RP proposed by CoC.[115] In the case of *M/S Nithin Nutritions Pvt.*,[116] for instance, it was held by the NCLAT that the CoC has the authority to provide for changes in the appointment of RP without any specific reasons. The ultimate power to appoint RP lies with the CoC,[117] and AA is duty-bound by it. Therefore, in order for the maximisation of the value of the assets of the CD and to safeguard the goal of corporate rescue, it is essential that independence is vested in the appointment of RP whether the relationship is of an economic, familial, or any other nature. It is essential that an RP acts with objectivity in their professional dealing as provided by the code of conduct contained in the IP Regulations.[118]

RP and Resolution Applicant

(a) Lack of independence criteria for RP and resolution applicant to ensure a fair CIRP process

RP plays three important duties to the resolution process in addition to managing the CD as a 'going concern'. These duties include 'the duty to prepare an information memorandum, solicit resolution applicants, and present all qualifying resolution plans to the CoC'.[119] RP is responsible for inviting EoI from interested and eligible resolution applicants, laying down certain evaluation matrix.[120] This evaluation matrix contains eligibility criteria regarding qualification and disqualification of resolution plans. The EoI is evaluated by RP, and further, a detailed memorandum along with the evaluation matrix is provided by RP to the potential resolution applicants,[121] and a resolution plan is requested. The resolution plan contains information with respect to the restructuring of the CD by way of merger, demerger or amalgamation,[122] as the case may be. Therefore, the possibility of the corporate rescue of the CD is dealt with based on the resolution plan. These resolution plans are submitted to the RP, who examines the same and presents them to the CoC.[123] The CoC approves the resolution plan with not less than 66% of the voting share of the FCs by value.[124] NCLT then sanctions the plan, and upon approval, the plan becomes binding, and the company is revived by the resolution applicant.[125]

The resolution plans submitted by the resolution applicants, i.e., the potential acquirers, would expect a fair process. A proper process would invite more prospective applicants, and there would be better chances of revival of the CD[126] keeping in line with the goal of corporate rescue. It is imperative to have a fair process to have an environment conducive to efficient acquisitions. However, such a goal of corporate rescue is hampered by the present lacunae in laws regarding the independence of RP from the resolution applicant. The Code is silent regarding the conflict of interest between the RP and resolution applicant. There exists no provision where the RP and resolution applicants should be independent of each other. The lack of independence between these RP and resolution applicants posed an issue in the *Ruchi Soya Industries Ltd*[127] case. In this case, there was a conflict of interest between the resolution applicant and the RP, as the same law firm represented one of the resolution applicants, Adani Wilmar and RP of Ruchi Soya. Later on, after Patanjali Ayurveda challenged this, the law firm resigned to avoid conflict of interest. However, the case depicts how the righteousness of the CIRP would have been seriously questioned if the party inviting the bids and the bidder were both represented by the same entity.

(b) No Guidelines regarding the framing of eligibility criteria

In addition to the lack of independence, the Code also does not prescribe any clear guidelines concerning the eligibility criteria that could be framed by the RP.[128] This lack of guidelines can be an obstacle to achieving the goal of corporate rescue. RP has broad discretion in framing these criteria, which can cause biases and impartiality on RP's part favouring specific bidders.[129] Therefore, eligibility criteria can be laid down to select specific bidders or prevent specific bidders during CIRP from submitting a resolution plan. The RP prepares the evaluation matrix and circulates the information memorandum. This issue was raised in the *MK Shah Exports Ltd* case,[130] wherein the CIRP process was initiated for a tea company. All the major tea companies operating in the country had their net tangible worth hovering between ₹ 1.5 - 2 billion. However, one of the eligibility criteria set by the RP was that the resolution applicants should have a minimum net tangible worth of ₹ 4 billion. The NCLT held such eligibility criteria as arbitrary and unreasonable. Therefore, the lack of standards, ethics and proper framework for the functioning of the RP will hinder the goal of corporate rescue as it will discourage prospective resolution applicants, especially foreign bidders, to submit a resolution plan. Such will attract fewer bidders or resolution plans. Consequently, there is a possibility of this leading to a lack of competition and sub-standard plans that might be rejected by the CoC, which will lead to more liquidation as opposed to the corporate rescue. Though such arbitrary guidelines can be challenged before the NCLT, such would lead to high legal cost and time involvement, which goes against the very spirit with which the Code was implemented.[131]

Independence of RP from CD- Problem of Information Asymmetry

Under the Code, as mentioned above, when the CIRP is initiated, the RP takes over the management of the company. Still, in reality, it is the CoC who assumes control over the management. RP and CoC are the two main guiding forces responsible for safeguarding the goal of corporate rescue. The current insolvency Code in India is creditor-driven, as held in the case of *Essar Steel Ltd*[132] by the Supreme Court. The Supreme Court based its reasoning on the rationale that '*the FC's are fully informed about the viability of the corporate debtor and the feasibility of any proposed resolution plan*'.[133] Therefore, the Code envisages the commercial wisdom of the majority of creditors to lead to the corporate rescue of the CD, and RP also performs a significant duty, as explained above. The involvement of the managers, promoters and shareholders of the CD is limited to providing assistance and co-operating with RP[134] Such a creditor-driven approach towards insolvency fails to consider the concentrated shareholding ownership in India, which is creating a problem of information asymmetry. This, in turn, is making a hindrance to achieving the goal of corporate rescue.

Corporate ownerships in India are concentrated with government, promoters, business families holding majority shareholding.[135] Promoter dominance has roots in India since independence, with companies flourishing in the weak-equity market environment.[136] The predominant concentrated corporate ownership in India, which follows the insider system of corporate governance,[137] leads to the problem of information asymmetry. Corporate disclosure is dichotomous and influenced by ownership models, i.e., concentrated and dispersed. Germany and Japan have highly concentrated ownership, whereas the ownership pattern in USA and UK is dispersed.[138] When the ownership model is dispersed, there are arm's length relations between managers and shareholder and market efficiencies is relied upon for efficient disclosure.[139] However, the trend is the opposite when ownership is concentrated. The management is related to controlling owners (government/families/promoters) in Indian companies[140] and often influences executives' appointments. Hence, these controlling owners hold access to information relevant to the prospective rescue of the company, thereby having an advantage of information symmetry. There are at a significant competitive advantage to construct the valuation of distressed companies because of off-record preparations and associations amongst them as opposed to a resolution applicant, an outside bidder.[141] However, during CIRP, the RP may receive little or no co-operation from these individuals, privy to relevant information.[142] Section 18 of the Code has laid down that an RP can collect data relating to assets, finances, and operations of the CD for determining the financial position. However, even with this provision, the RP might not be able to provide all relevant information to the resolution applicant. Moreover, having a creditor driven approach is not as fruitful in India, as banks (creditors) do not constitute a powerful interest group. Therefore, having unprecedented interest with the controlling owners, they may not possess the information and may not have any good enticement.

Additionally, public sector banks dominate the debt market in India.[143] The banks' boards are verbalised by the political interests of the influenced bureaucrats.[144] This might affect the credibility of the creditors to judge a resolution plan, where rescuing the distressed company will not be their primary aim. Such situations would require the involvement of the CD.

In furtherance to the above point, the CD's promoters are totally side-lined during the CIRP, as mentioned above. As the Code is manager displacing, this has led to an overemphasis on the independence of RP and CoC from the promoters of the CD. In the case of *RBL Bank Limited v. MBL Infrastructures Limited*,[145] the Court observed that '*in insolvency proceedings, the promoters of Insolvent Company is the most natural person to submit a plan unless the insolvency is caused due to his acts of omission and commission or if he has an indulgence, fraud, malfeasance or other criminal activity and causes financial loss to creditors, knowingly or with criminal intent*'.[146] The NCLT in the above case held that promoters are not as a class disqualified to submit a resolution plan under section 29A of the Code. However, such a position is not affirmed by the Supreme Court as in an earlier case of *Chitra Sharma v. Union of India*,[147] the apex court held that section 29A made the promoters ineligible to participate in CIRP. It is often argued that promoters and managers are the people responsible for the distressed position of the company, so it is deemed correct to side-line these very persons responsible. However, the mechanism of CIRP is not to punish management, except in cases of fraud.[148] Instead, the task of insolvency is to revive the distressed entity by restructuring debt and cash flow-generating concerns.[149] Insolvency is not a moral failure but an economic failure.[150] Therefore, the Code using a one-sise-fits-all approach regarding the treatment of promoters can lead to hindrance in achieving the goal of corporate rescue.

Consequently, the problem of information asymmetry cannot be ignored when the shareholding pattern is concentrated. There is a strong focus on independence between the CD and the RP and CD and the CoC. Regulation 3(1) and section 23A stipulates that only a person who has no relation whatsoever with CD can be appointed as an RP. Moreover, an FC who is a related party for the CD cannot exercise voting rights in the CoC meetings.[151] Therefore, with the Code adopting an approach where the CoC replaces the management of the CD, this constructs a major challenge to the RP to procure relevant information and thereby the resolution applicant to submit a resolution plan that would successfully lead to resolution and revival of the CD. Such overemphasis is creating a strong bias towards more liquidation as opposed to rescue and, therefore, hinders the goal of corporate rescue. On the other hand, as noted in earlier sections, the independence of RP from the CoC is neglected by the Code, which is also creating problems in the revival of the CD.

Some illustrative recommendations relating to the institution of RP

It is the need of the hour for IBBI to strengthen the code of conduct for IPs in order to iron out possibilities of undue discretion being exercised by RP and upon them by CoC, thereby ensuring a fair CIRP process. We acknowledge the limitation in providing substantive recommendations based on comparative analysis as the institutions involved in the insolvency regimes are varied. For instance, the insolvency laws in USA are more debtor-friendly while Indian insolvency laws are creditor friendly. The standard practice in India is to adopt laws from UK to resolve a complex legal issue.[152] The Indian courts have, on many occasions, directly applied UK decisions in their judgements to fill gaps in domestic laws.[153] India in this regard can adopt from the UK insolvency law, which prescribes an 'Insolvency Practitioner Code of Ethics' for Insolvency Practitioner, who is similar to an RP. The code of ethics defines 'objectivity as one of its fundamental principles mandating the insolvency practitioner not to allow bias, conflict of interest or undue influence of others to override professional or business judgements.'[154] The IP must apply adequate safeguards to counter conflicts of interest such as consulting other practitioners or third parties, using information barriers such as confidentiality and secure filings, and terminating relationships that give rise to a conflict of interest or seeking directions of the court.

Additionally, a penal provision similar to section 184 of the Code can be included, providing punishment for the debtor or creditor to provide false information to RP.[155] Such disciplinary sanction should also be extended to RPs found guilty of favouring specific resolution applicants. This measure would provide for strict action against the arbitrary actions of RP and create a conducive and investor-friendly environment in the Indian economy, where the goal of corporate rescue would be safeguarded.[156]

CONCLUSION

In this paper, we have analysed the lacunae in the provisions relating to the functions and constitution of the CoC and the role of RP that obstructs the goal of corporate rescue. We have addressed the gaps in the existing literature regarding the requirement to have independence of RP and a code of conduct for CoC. The role of CoC in achieving the goal of corporate rescue is significant as issues with the constitution and appointment of CoC and challenges that arise due to the broad discretion bestowed on the CoC jeopardise the goal. A code of conduct for the CoC or the establishment of governance standards in any other form is the need of the hour.

The role of RP though being merely administrative as opposed to adjudicatory,[157] the very nature and functions that RP carries out does not rule out the hypothesis of a biased administration of CIRP. The gaps in the legislation may allow a biased or non-independent RP to administer the rights and benefits of a particular stakeholder beneficially at the expense of the others. The code of conduct can be subjected to multiple interpretations, which can be misused. For this reason and resolution professionals' proximity to the CIRP process, the independence of the RP and its impartiality assume importance.

The lacunae in laws relating to the Code is testified by the plethora of cases where the CoC and RP acted in contravention with the Code and in their self-interest. This posits serious questions to the creditor driven approach adopted by India for their corporate resolution process. All in all, many of these problems discussed above arise due to the creditor-driven approach. The Binani Cements case bears witness to the fact that courts are validating a resolution plan that fulfils the object of value maximisation of the assets of CD and is in the interest of all company stakeholders. Therefore, a market-driven approach (i.e. acceptance of a plan which balances the interest of stakeholders), as opposed to a creditor-driven system, could be considered by the Indian insolvency regime. However, we recognise the fact that a market-driven approach could have its own issues, as Indian insolvency laws are at a nascent stage.

It is rather unfortunate that with regards to the discrepancies at the moment, we are just focussing on the technical aspects of the Code to achieve certain goals but not the qualitative aspects. This indicates that the governance standards are not sufficient. The introduction of corporate governance standards was with an aim to not only focus on profit maximisation for companies but also to achieve an end result that balances the interest of all stakeholders. A number of reforms were brought in corporate governance after multiple scams. Unlike the development of corporate governance, the Indian regime should adopt a precautionary approach rather than a problem-solving approach in developing the 'insolvency governance' standards before the integrity of the Code crumbles. Would India set the benchmark for other jurisdictions in developing insolvency governance?

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24

A RECURSIVE PLS-SEM APPROACH TO DETERMINE CAUSAL FACTORS OF CORPORATE BANKRUPTCY TREND IN INDIA

— *Abhishek Halder, Shashank Prakash Srivastav and Prateek Nahar*

Executive Summary

The insolvency-related legal processes are necessary but not sufficient to alleviate corporate distress, which leads to bankruptcy. Bankruptcy is not a sudden phenomenon but a continuous process that evolves through various stages of early signs, neglect of financial and non-financial symptoms in addition to inappropriate management actions. Our study aims to identify the factors causing corporate bankruptcy trend in India. For this, the study investigates aggregate-level factors associated with independent variable constructs of conditions of the banking sector, Indian economy and debt market that have significantly contributed to the dependent variable construct of corporate bankruptcy after the implementation of Insolvency and Bankruptcy Code, 2016 (IBC / Code) in India. Our study uses 23 measurable indicators for theoretical constructs of condition of banking sector, condition of Indian economy, debt market dynamics and corporate bankruptcy. The sample set consists of 1844 companies liquidated between April 1, 2017 and March 31, 2021. The data was collected from credible sources of information and was structured as a time series of quarterly granularity. Research methodologies of exploratory factor analysis (EFA) and partial least squares structural equation modelling (PLS-SEM) are employed. Recursive modelling reveals that barring credit-deposit ratio (CDR), external debt and Goods & Services Tax (GST) collection, all indicators are insignificant. It implies that firms with higher credit-deposit ratio, excessive external debt and tax avoidance history are causing a bankruptcy trend. The study discovers a pro-liquidation trend against pro-reorganisation trend indicating value destruction. It has major regulatory and economic implications for insolvency and bankruptcy reforms.

Keywords: Corporate Bankruptcy, Financial Distress, Debt Market, Credit-Deposit Ratio, Partial Least Squares Structural Equation Modelling.

INTRODUCTION

The extent of corporate debt distress is exemplified by three factors, namely macroprudential regulation of bank lending, micro prudential policies on credit quality and the debtor-specific characteristics[1]. The macroprudential regulation of bank lending envisages instruments of capital, liquidity and provisioning vary dynamically according to macro-environment (Gopinath, 2010). Macroprudential regulation complies to the general equilibrium theory (Allen & Gale, 2009) but micro prudential administrators tend to ignore its effects. Nevertheless, micro prudential actions implemented at institutional level can destabilise the entire financial system (Hanson et al., 2011). The interconnectedness of the financial system gives birth to system-wide complementarities and conflicts between macroprudential regulation and micro prudential policies. Effective cooperation through control mechanisms for systemic and idiosyncratic risks is essential in their joint pursuit of financial stability (Osinski et al., 2013). The insolvency-related legal processes are necessary but not sufficient to alleviate corporate debt distress, which leads to bankruptcy (Laryea, 2010).

Insolvency as the main cause of bankruptcy (Cisko & Klieštik, 2013) is challenged by some studies on bankruptcy risk which consider negative profitability as a prerequisite for bankruptcy (Scott, 1981; Lukason & Laitinen, 2019). Due to inherent dynamism in economic and financial activities of companies, it has become essential to analyse bankruptcy risk from different viewpoints such as financial stability, functional balance and scoring methods (Bordeianu et al., 2011). Bankruptcy is not a sudden phenomenon but a continuous process that evolves through various stages of early signs, neglect of financial and non-financial symptoms in addition to inappropriate actions (Korol, 2013). As bankruptcy risk increases, information (mis)communication also varies as per reporting timeliness, supporting the agency theory through asymmetric information (Lukason & Camacho-Miñano, 2019). Time spent in bankruptcy is one of the indirect bankruptcy costs because the company's position in goods and capital market is negatively affected by delays in bankruptcy process (Singhal & Zhu, 2013) Appropriate incentives for constituencies such as shareholders, managers, senior and junior creditors, courts, judges among others play a vital role in explaining bankruptcy outcomes (Ayotte et al., 2012).

India witnessed subdued credit growth for some time after the global financial crisis of 2008 against a private corporate debt-driven growth in pre-crisis period (Nagaraj, 2013). Global financial conditions are associated with rate of growth of corporate leverage in emerging markets (Alter & Elekdag, 2020). The leveraged firms attracting more investments motivate higher corporate borrowing inspite of fluctuating debt serviceability and debt capacity. Lower levels of debt improve welfare, promotes financial stability and enhances economic growth but higher levels of debt increased volatility, uncertainty and retards growth (Cecchetti et al., 2011). The non-linear leverage-investment relationship implies that the debt level negatively impacts investment beyond a threshold as the agency cost of debt increases and marginal returns on investment reduces (Cecchetti et al., 2011; Gebauer et al., 2018; Memos et al., 2021) thereby escalating bankruptcy cost. A report[2] reveals that around 40% of the corporate debt in India are with firms that are incapable of paying the interest costs. This is because there are external as well as internal risks acting as the determinants of corporate bankruptcy (Horváthová & Mokrišová, 2018).

An analysis[3] of 60 corporate debtors resolved under the IBC between September 2019 and September 2021 reveal that the longer bad loans remain on banks' balance sheets, the lower is the amount banks succeed in recovering, independent of the type of exposure or borrower. This inverse time-recovery relationship is to be controlled by reviewing provisioning norms, streamlining micro prudential policies of asset classification and convergence with actual recovery related data[4]. To this end, the Reserve Bank of India (RBI) enshrined certain fundamental principles in the prudential framework for resolution of stressed assets[5]. Former RBI Governors, Viral Acharya[6] and Urijit Patel[7] have also emphasised upon recognition, restructuring and resolution of stressed assets. Acharya (2017) explained two models as entities for resolution of stressed assets viz. Private Asset Management Company (PAMC) and National Asset Management Company (NAMC). He also proposed alternative ways of recapitalisation to economise total cost such as private capital raising, asset sales, mergers, tough prompt corrective action and divestments. Patel (2017) highlighted strengthening legal framework, evolving regulatory architecture and institutional measures are crucial for the credibility and outcome of all resolution efforts.

In this context, our study aims to investigate aggregate-level factors associated with banking sector, Indian economy and debt market that have significantly contributed to corporate bankruptcy after the implementation of the IBC[8] in India. Our exploratory research adopts a non-parametric approach of PLS-SEM to overcome the shortcomings of the parametric approach of co-variance based structural equation modelling (CB-SEM). It provides a lucid account of complex cause-effect relationship among interconnected variables in fiscal space. Our study finds that although debt market acts as a channel for financial flows between banking sector and macroeconomy, its dynamic nature has hardly impacted the trend of corporate bankruptcy in India. The reason comprises of issues and challenges of Indian debt market[9] as is still developing and large segments of savers and investors do not participate in it. Furthermore, credit-deposit ratio, external debt and tax collections emerged as significant determinants of corporate bankruptcy in India in the post IBC period. The results will assist academicians, practitioners and policymakers to align their actions and suitably reform the existing legal, economic and institutional milieu of corporate insolvency and bankruptcy in India.

The remaining sections of this paper are organised as - First, it discusses the relevant prior literature and identifies the research gap. It then describes data and methods employed in this study. It further elaborates the results and interpretations and then offers our conclusion.

RELATED LITERATURE

Many researchers have delved into the outcomes of capital structure choices at the firm level. There is no universal theory of capital structure or debt-equity choice but some useful conditional theories[10] (Myers, 2001). Modigliani & Miller (1958) showed that value of the firm is invariant to its capital structure under given perfect market and rational investor behavior assumptions. Bradley et al. (1984) used a single period model to empirically explain three determinants of optimal capital structure as costs of financial distress, level of non-debt tax shields and variability of firm value. Titman & Wessels (1988) discuss various attributes of debt-equity choice such as asset structure, non-debt tax shields, growth, uniqueness, size, industry classification, earnings volatility and profitability with respect to their relationship with optimal capital structure. The magnitude of bankruptcy costs (costs associated with liquidation or reorganisation) has a considerable bearing on the question of how much debt is optimal for the firm to have its capital structure (Warner, 1977). Rajan & Zingales (1995) contend that previous works focus on size or power of the banking sector thus classifying countries as 'bank-based' and 'market-based' economies but it is not the only basis of institutional differences accounting for corporate leverage. They opine that bankruptcy law, tax code, state of development of bond markets and patterns of ownership may also play a role. The existing capital structure reflects the history of investment and financing decisions of a firm and hence depends upon the changing role of debt and equity over time (Friedman, 1985). For example, the net debt issuing activity experiences sharp decline following debt covenant violations and exercise of creditors' control rights resulting in reduced credit availability (Roberts & Sufi, 2009). Nevertheless, prior literature has established that firms with higher growth prospects, measured by more valued growth opportunities, tend to have lower levels of debt in their capital structure (Long & Malitz, 1985; Smith Jr & Watts, 1992; Barclay & Smith Jr, 1999).

Institutional development defined by size, age and ownership is instrumental in explaining cross-country variation in financial constraints of firms (Beck et al., 2006). The scale, scope and timing of credit from financial institutions is driven by idiosyncratic lending behaviour and business models. In bank-based economies like India, stability of the banking system in defining investment dynamics as these markets are emerging (Moradi et al., 2016). Improved credit availability and better information production increases relative borrowing from banks, particularly state-owned banks and reduces financial constraints of firms (Behr et al., 2013). Endogenous variations in bank capital radiate shocks in the banking system by means of cash flows, net interest margins and asset valuations (Disyatat, 2011). In a competitive banking ecosystem, banks need to determine credit-worthiness of potential borrowers to maintain credit standards. However, temporal variation in bank lending standards results in a repeated game of bank lending with periodic credit crunches and swings between high and low credit allocations (Gorton & He, 2008). In such a dynamic lending environment, credit must be restricted only to potential borrowers with positive net present value. Additionally, bank credit policies must be sensitive to demand-side conditions to control frequency of credit cycle (Rajan, 1994). Weak credit principles, fragile operating procedures, incapable loan specialists, high credit spreads and lack of timely monitoring and credit appraisal contribute to higher volumes of non-performing loans (NPLs) (Khan et al., 2020). Several studies have confirmed that NPLs are major indicator of credit risk affecting the stability of the banking system and having the potential to snowball into a crisis situation (Feijó, 2011; Ivanović, 2016; Vouldis & Louzis, 2018). Thus, it is essential to identify the intrinsic factors that impact the stability of the banking sector.

There are several factors that lead to the growth or decline of non-performing loans, such as macroeconomic variables and bank-specific variables, bank ownership structure, corruption and information sharing (Ahmad, 2013). The existing literature shows that rapid growth in NPLs leads to bank distress and a banking crisis in an extreme scenario (González, 1999). This motivates us to study the factors that determine the bankruptcy trend in India in association with parameters that indicate the health of the banks. The study derives its relevance from the intention for bankruptcy reforms in India. The issuance of long-term debt increases as a result of greater creditor rights in bankruptcy reforms in emerging economies (Hasan et. al, 2020). The balance between the creditor and debtor rights determines the nature of national bankruptcy regimes being classified as pro-liquidation or pro-reorganisation (Stef and Dimelis, 2020). In the post-IBC period, the number of firms liquidated under IBC far surpasses the number of businesses that recovered (IBBI Quarterly Newsletters, 2021). This suggests that the Indian bankruptcy regime is a pro-liquidation one. The increase in the creditor rights in a pro-liquidation regime impairs its judicious use and decreases cost of borrowing owing to liquidation bias (Vig, 2013). This resulted in increase in credit supply through multiple channels of credit in post-IBC period for financially distressed firms offered at a cheaper cost of debt (Gopalan et al., 2016; Rodano et al., 2016; Vig, 2013). The non-performing assets (NPA) create a risk of capital erosion and also a sign of debtor distress. NPAs and stressed assets erode bank capital thereby bleed balance sheets. Berger & DeYoung (1997) put forward four hypotheses to explain the possible causes behind stressed assets: bad luck, bad management, skimping behavior and moral hazard problems. Sahoo (2015) argues that the growth of NPAs would be caused broadly by three factors, namely, business environment, borrowers and banks. PwC (2014) reports that high credit growth rate is accompanied by the accumulation of stressed assets within the banking sector, which supports Raghuram Rajan's argument that excessive lending during upturn results in stressed assets. The experience of half a decade of a new insolvency regime in India shows that it has not helped in reducing bad loans (Tandon and Tandon, 2019). This questions the sustainability and robustness of the banking sector in India.

Extant literature explains that the development of the debt market determines the nature of the credit ecosystem in the country. Central to this idea lies credit ecosystem influencing the extent of maturity of the capital markets (Djankov et al., 2008) co-terminus with the rising entrepreneurial activities (Francis et al., 2009). Researchers also opine that credit rights is one of the key determinants of debt market development (La Porta et al., 1997, 1998; Djankov et al., 2007; Haselmann et al., 2010). Distressed firms are able to improve their performance relative to non-distressed firms through greater availability to credit and cheaper cost of borrowing (Bose et al., 2021). Corporate failure can be attributed to two interrelated categories, namely economic distress and financial distress (Danilov, 2014). Economic distress arises from the flaw in the business model that becomes incapable of utilising the assets to generate economic profit. A firm in economic distress may generate profit, but not sufficient enough to offset the opportunity costs of inputs (Danilov, 2014). Financial distress is caused by the insufficiency of revenues to pay the debt obligations of the company in a timely manner as promised to its creditors. It has two forms – insolvency and bankruptcy. An insolvent firm has more assets than liabilities on its balance sheet but is unable to meet current financial obligations. In contrast, a bankrupt firm has lesser assets than liabilities and thus a negative net worth. Financial distress can lead to economic distress when a firm is forced to sell off its profitable assets to pay down its debt. Alternatively, companies face financial distress due to external shocks or temporary setbacks despite being economically viable (Danilov, 2014).

The IBC lays down a process by which firms in financial distress can seek a resolution or exit. The three different states of distress, insolvency and bankruptcy in debt relationships deal with problems in future payments (Sengupta, Sharma and Thomas, 2016) which invariably is linked to the NPAs of the banking sector. The moderation of gross non-performing assets (GNPA) began in 2019-20 and its level reached 7.3% by end-March 2021 (RBI Report, 2021). Write-offs are the predominant recourse for GNPAs which impacts bank profitability. Off late, foreign banks reported increasing accretions to NPA and deteriorating asset quality due to amalgamation of a troubled private sector bank with a foreign bank. The decline in the slippage ratio reflected this impact in case of foreign banks. Banks consider bankruptcy risk to decide whether to disburse a loan (Campbell 2012). Bankruptcy risk takes place at all stages of the company's life cycle (Rybak, 2006). It is borne out of the inevitability of management activities conditioned by the hazy business environment and insufficient company resources.

A bibliometric analysis of literature corpus of corporate bankruptcy was performed which revealed 24 thematic clusters that evolved during two subperiods viz. 1968-2010 and 2011-2022. We believe 2010 was a watershed in the outlook towards corporate bankruptcy due to global events. On one hand, the world was recovering from financial crisis of 2008 and on the other hand, Eurozone was engulfed into sovereign debt crisis. The thematic evolution of corporate bankruptcy is enlisted in Table 1. The themes are grouped into basic themes, emerging themes, niche themes and motor themes. The basic themes include bankruptcy prediction, corporate governance, financial distress, risk management among others. The emerging themes include bankruptcy risk, financial risk and financial performance. The niche themes include bankruptcy law, efficiency and corporate social responsibility. The motor themes include capital structure, insolvency and liquidation. These four groups are displayed in four quadrants in Fig. 1. Table 2 shows the keywords occurring together in the conceptual structure of corporate bankruptcy.

Table 1: Thematic Evolution of Corporate Bankruptcy

The table enlists all the themes which evolved during two subperiods viz. 1968-2010 and 2011-2022 in decreasing order of weighted inclusion index (WII)

Sl. No.	1968-2010	2011-2022	Words	WII	Occurrences
1	Bankruptcy prediction	Bankruptcy prediction	Bankruptcy prediction, Neural networks, Credit risk, Data mining, Discriminant analysis, Financial ratios, Genetic algorithms, Support vector machines	0.49	22
2	Liquidation	Bankruptcy	Liquidation, Insolvency, Reorganisation	0.40	11
3	Bankruptcy	Bankruptcy	Bankruptcy, Default	0.36	65
4	Capital structure	Capital structure	Capital structure	0.32	16
5	Corporate finance	Capital structure	Corporate finance, Accounting	0.32	4
6	Bankruptcy	Corporate governance	Corporate governance, Ownership structure, Board composition, Law and finance, Debt	0.29	36
7	Privatisation	Corporate bankruptcy	Diversification	0.29	2
8	Risk	Bankruptcy	Risk, Valuation	0.23	4
9	Corporate finance	Corporate bankruptcy	Enron	0.21	4
10	Capital structure	Bankruptcy	Bankruptcy law, Asymmetric Information, Efficiency	0.20	4
11	Liquidation	Corporate bankruptcy	Corporate bankruptcy	0.18	9
12	Genetic algorithm	Bankruptcy prediction	G33	0.16	3
13	Business failures	Bankruptcy risk	Financial performance	0.15	2
14	Capital structure	Creditors	Governance	0.14	3
15	Bankruptcy	Financial distress	Financial distress, Leverage	0.09	12
16	Bankruptcy prediction	Bankruptcy	Financial crisis, Restructuring, Corporate distress	0.09	5

Sl. No.	1968-2010	2011-2022	Words	WII	Occurrences
17	Bankruptcy	Capital structure	Risk management, G32	0.07	4
18	Bankruptcy	Corporate bankruptcy	G34, Investment, Ownership	0.07	3
19	Bankruptcy prediction	Capital structure	Finance, Forecasting	0.07	4
20	Bankruptcy prediction	Financial distress	Corporate failure, Multiple discriminant analysis, Z-score	0.07	3
21	Capital structure	Corporate governance	Agency costs	0.06	3
22	Capital structure	Financial distress	Bankruptcy costs	0.06	3
23	Bankruptcy	Bankruptcy prediction	Neural network, Default risk, Survival analysis	0.04	3
24	Capital structure	Bankruptcy risk	Corporate social responsibility	0.04	2

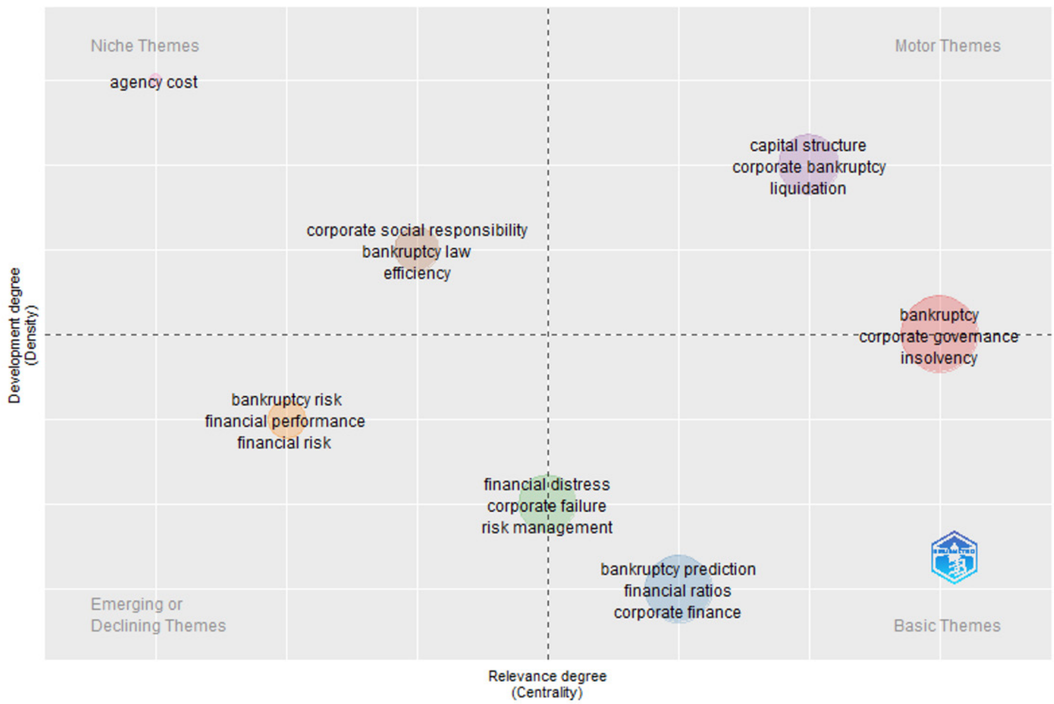

Fig. 1: *Thematic map based on centrality and density depicting basic themes, emerging or declining themes, niche themes and motor themes of corporate bankruptcy in clockwise direction*

Table 2: Co-word network

The table enlists 5 clusters based on co-words in conceptual structure of corporate bankruptcy

Clusters	Nodes
1	Bankruptcy, Insolvency, Corporate finance, Corporate failure, Credit risk, Default risk, Risk, Finance, Leverage, Logistic regression, Corporate distress, Corporate strategy, Restructuring, Survival analysis, India, Distress
2	Corporate governance, Board of directors, Ownership structure, Governance, Agency theory, Board composition, Debt, Enron
3	Bankruptcy prediction, Financial ratios, Financial crisis, Machine learning, Neural networks, Data mining, Financial performance, Corporate bankruptcy prediction, Financial risk
4	Financial distress, Capital structure, Corporate social responsibility, Bankruptcy law, Risk management, Z-score, Bankruptcy costs, Neural network, Efficiency
5	Corporate bankruptcy, Liquidation, Reorganisation, Default, Chapter 11, Corporate insolvency

DATA AND METHODOLOGY

This section describes sample selection, data sources and methods employed in this study. Our study uses 23 measurable indicators for theoretical constructs of condition of banking sector, condition of Indian economy, debt market dynamics and corporate bankruptcy. These indicators capture the constructs from different lenses to ensure holistic viewpoints. Data for these indicators was assimilated from publicly available repositories of government authorities and privately-held databases. The data was structured as a time series of quarterly granularity covering the period from April 1, 2017 to March 31, 2021. Software applications of IBM SPSS and SmartPLS were used to perform exploratory factor analysis and PLS-SEM. The construct reliability and validity were tested to verify that our constructs reflect the approximate truth that our operationalisation accurately concludes. The criterion-related validity was tested through discriminant validity to check that our operationalisation diverges from other operationalisations. Lastly, multicollinearity between variables was checked using Variance Inflation Factor (VIF).

Sample Selection

The population denoted by the universal set U comprises of all companies facing higher level of financial distress during the study period. A sample set, denoted by S, is derived from this population using purposive sampling technique. This sample S consists of a set of 2265 companies admitted under corporate insolvency resolution process (CIRP) as on September 30, 2021. It is subdivided into four functional subsets viz. CIRP yielding resolution plans (denoted by K), CIRP ending with order of liquidation (denoted by L), liquidation processes ending with dissolution (denoted by M) and voluntary liquidation processes ending with dissolution (denoted by N). The subset K consists of 421 companies which have been successfully rescued from financial distress. The remaining 3 subsets L, M and N combinedly constitute 1844 companies, which were not recused from financial distress and hence were liquidated. These 1844 bankrupt companies form our sample set for this study. Fig. 2 depicts our step-wise process of sample selection.

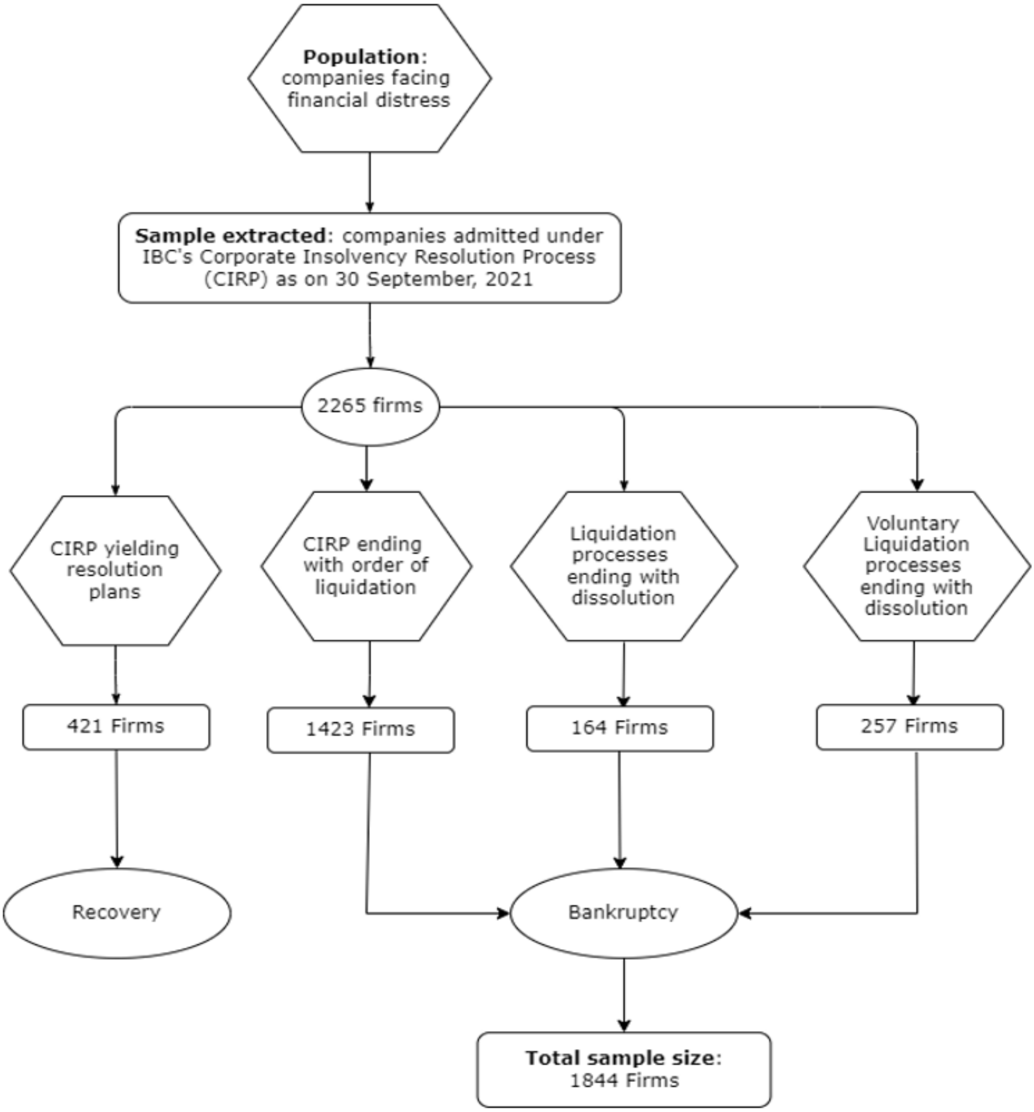

Fig. 2. *Flowchart depicting the process of sample selection*

Data Collection

The dependent variable construct for this study is corporate bankruptcy trend. The three subsets of L, M and N in our sample S are measured using three indicator variables viz. total admitted claims during CIRP ending with liquidation (denoted by l), total admitted claims in liquidation (denoted by m) and realisation of assets in voluntary liquidation (denoted by n) respectively. The independent variable constructs for this study are condition of banking sector, condition of Indian economy and debt market dynamics. We tried to holistically capture these constructs using different indicator variables. The condition of the banking sector is encapsulated using continuous variables of gross non-performing assets (GNPA), net non-performing assets (NNPA), gross advances (GAS), credit to deposit ratio (CDR), capital adequacy ratio (CAR), proportion of GNPA and NNPA in gross advances (GNPA/GAS and NNPA/GAS), fraction of gross advances in India's Gross Domestic Product (GAS/GDP). The condition of the Indian economy is captured using continuous variables of GDP growth rate (GPG), gross fiscal deficit (GFD), consumer price index (CPI), indirect taxes collected (GST), external sector debt (ESD), net foreign domestic investment (NFDI), net portfolio investment (NFPI) and foreign exchange reserves (FXR). The debt market dynamics is covered for public debt and private debt using continuous variables of public issues of corporate debt (PICD), private placement of corporate bonds (PPCB), outstanding corporate bonds (OSCB) and trading amount of corporate bonds (TACB). We collected quarterly data for 20 indicators of independent variable constructs from credible sources of information. These sources include Reserve Bank of India (RBI) working papers, reports and database on Indian economy, CMIE database of economic outlook, financial stability reports, Security and Exchange Board of India (SEBI) statistics, Insolvency and Bankruptcy Board of India (IBBI) newsletters, working papers and reports, and final orders passed by National Company Law Tribunal (NCLT). Based on the date of order of liquidation (in case of CIRP) or date of liquidation (in case of dissolution), we assimilated the data for three indicators of dependent variable construct on a quarterly basis. Fig. 3 depicts the sources of each of the measured variables. Empirically, sample set S and constructs can be represented as:

$$S = \{x \in S \mid x \in L \text{ or } x \in M \text{ or } x \in N\}$$

$$\text{Condition of banking sector } (X_{1t}) = \left\{GNPA_t, NNPA_t, GAS_t, CDR_t, CAR_t, \frac{GNPA}{GAS}_t, \frac{NNPA}{GAS}_t, \frac{GAS}{GDP_t}\right\}$$

$$\text{Condition of Indian economy } (X_{2t}) = \{GPG_t, GFD_t, CPI_t, GST_t, ESD_t, NFDI_t, NFPI_t, FXR_t\}$$

$$\text{Debt market dynamics } (X_{3t}) = \{PICD_t, PPCB_t, OSCB_t, TACB_t\}$$

$$\text{Corporate Bankruptcy } (Y_t) = \{l_t, m_t, n_t\}$$

Methods

We employ exploratory research methods of exploratory factor analysis (EFA) and recursive PLS-SEM on our structured time-series dataset to establish a causal relationship between independent and dependent variable constructs and to identify factors significantly contributing to corporate bankruptcy trend in India. To achieve this objective, we initially use EFA to identify the hypothetical factors which can parsimoniously explain the covariation observed among the sets of measured variables. This helps us to determine the order and structure among the measured variables. A factor is a latent variable that influences more than one measured variable and that accounts for the correlations among these observed measures. Thus, measured variables are interrelated due to their common cause towards explaining the latent variables. To confirm the hypothetical factors and to establish unidirectional causality through path models, we use PLS-SEM recursively. The results are checked for construct reliability and validity, discriminant validity and multicollinearity.

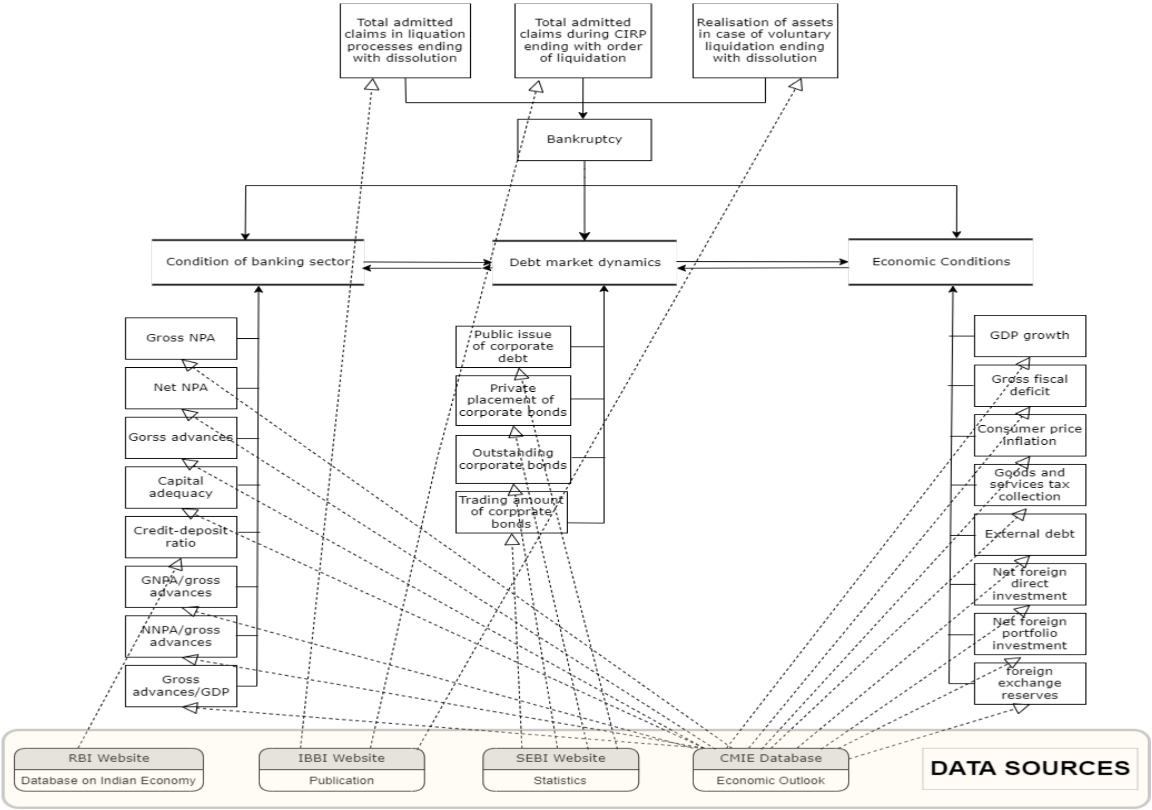

Fig. 3 *Schematic diagram depicting the sources of data*

Exploratory factor analysis

The relationships between constructs and their indicator variables are important because its knowledge helps us to map the theoretical constructs onto the empirical phenomena. For this, we initially employ Exploratory factor analysis (EFA)[11], which is a multivariate statistical method used to identify the structure among the measured variables based on covariation to reveal their order with respect to the constructs or factors. EFA is included in many commercial and free statistical packages (SAS, SPSS, Stata, R), out of which we have used SPSS. The 23 measured variables are selected for their utility as indicators of anticipated four factors (constructs). This means that the measured variables should adequately represent the domains related to the factors and not include variables from unrelated domains. For example, NPAs represent the domain of condition of banking sector from perspective of the objective of the study and the unrelated variable of consumer price inflation cannot be included in this particular domain. At least three measured variables are needed for statistical identification of the factor although more variables are preferable. Our construct of corporate bankruptcy consists of three measured variables, which fulfils this criterion. EFA gets operationalised in two parts, namely principal component analysis and common factor analysis.

Principal components analysis (PCA) is one of the techniques for analysing high-dimensional data. It analyses the entire correlation matrix and uses the dependencies between the measured variables to represent it in a lower dimensional form, while preserving as much information from the original dataset as possible. PCA is one of the simplest and most robust ways of performing such dimensionality reduction. PCA computes linear combinations of the original measured variables that explain as much information about these variables. The new measured variables, called components, are parsimonious representations of the original measured variables but are not the constructs. Instead, the measured variables influence the components. Therefore, readers should not be confused should refer to these measured variables as components and not factors.

Assuming that the measured variables are correlated because they are influenced by the same hypothetical construct, common factor analysis divides the total variance of the measured variables into common variance among the measured variables (communality or h^2) and unique variance (u^2). Unique variance is represented linearly as reliable but not shared variance (s^2) plus unreliable measurement error (e). Therefore, total variance explained by common factors is given by:

$$h^2 + (s^2 + e) = h^2 + u^2$$

Both PCA and common factor analysis produce estimates of communality, but only common factor analysis estimates the uniqueness (u^2) of each measured variable. Variables for which the common factors explain little variance may distort the EFA results. PCA components is used to find number of factors to retain for subsequent common factor analysis, but methodological researchers opine that common factor analysis is to be employed when the purpose is to identify latent constructs responsible for variation of measured variables. This distinction hardly makes a difference when there are greater than 40 measured variables. Since, our study includes 23 measured variables, common factor analysis is of greater relevance to us. It helps us define measurement instruments that reflects meaningful constructs.

Partial least squares structural equation modelling

Structural equation modelling (SEM) is a second-generation[12] multivariate data analysis method because it can test theoretically supported linear and additive causal models. It is used to examine relationships among variables of interest to prioritise one's focus. A structural equation model consists of two sub models: an inner model or structural model specifying relationship between independent variable constructs and dependent variable constructs, and an outer model or measurement model specifying relationships between constructs and their respective observed indicators or measured variables. In our study, the structural model comprises of dependent variable construct of corporate bankruptcy and independent variable constructs of condition of banking sector and condition of Indian economy. There are some distinct approaches to SEM, namely covariance-based SEM (CB-SEM), PLS-SEM and Generalised Structured Component analysis (GSCA). PLS-SEM[13] focusses on the analysis of variance and can be performed using many tools (PLS-Graph, VisualPLS, SmartPLS, WarpPLS, R). For the purpose of this study, we have used SmartPLS to perform PLS-SEM.

PLS-SEM is a soft modelling approach to SEM with no assumptions about data distributions. PLS-SEM is a good alternative to CB-SEM when there is requirement for high predictive accuracy, exact model specifications cannot be expressed and little theory support is available for applications. It is due to these merits of PLS-SEM over CB-SEM that we believe that it is an appropriate methodology for our study. However, it would be untrue to say that PLS-SEM does not have any demerits. It can give rise to multicollinearity issues if not handled well. Since arrows in the model are single-headed, it is not capable of modeling undirected correlation. It can create large mean squared errors in the estimation of path coefficients and bias loadings. Taking cognisance of all these downsides, we adopt it as our research method. This is because of its widespread acceptance across disciplines in recent years. This does not mean that we have neglected its demerits. The results of PLS-SEM obtained from SmartPLS also check for multicollinearity, reliability and validity and discriminant validity. Fig. 4 depicts measurement models and structural model in this study.

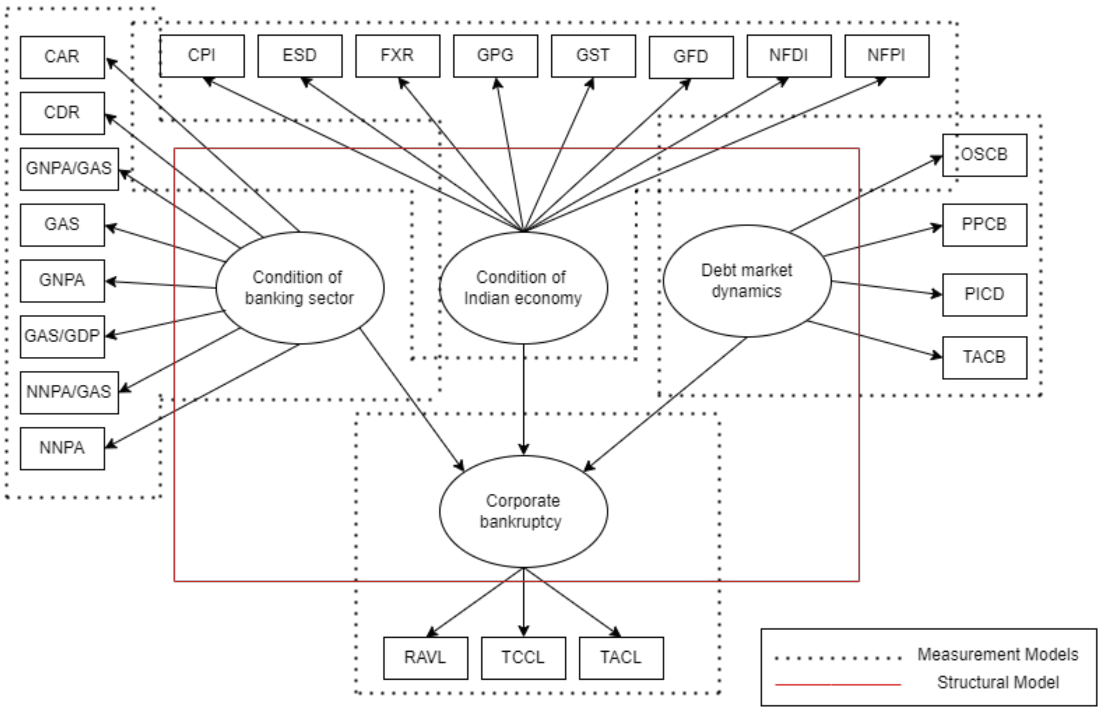

Fig. 4 *Measurement models (Outer models) and Structural model (Inner model) in SEM*

An iterative algorithm solves the structural equation model by estimating the constructs by using the measurement and the structural models in alternating steps, hence the name of 'partial' instead of ordinary least squares. Some examples of PLS-SEM type models are recursive, interaction, intervening, second-order, heterogeneity and multi-group models. The recursive model is same as the structural model that establishes unidirectional causality without a feedback loop. The first set relates the indicators of the independent variable constructs (x) to their associated measurement error (δ) and independent variable constructs (ξ).

$$x_i = \lambda_{xij}\xi_i + \delta_i$$

The second set describes the relationship between the indicators of the dependent variable construct (y), their associated measurement error (ε), and the dependent variable construct (η):

$$y_i = \lambda_{yij}\eta + \varepsilon_i$$

Finally, the third set deals with the relationship between the dependent variable construct (η) and independent variable constructs (ξ):

$$\eta = \gamma_{ij}\xi_i + \zeta_i$$

In the equation formulated above, the random disturbance term ζ do not reflect measurement error but is known as 'errors in equation' and reflect random disturbance.

Results and Discussion

Initially, we employed exploratory factor analysis for 20 indicators of independent variable constructs. Table 3 summarises the factor loadings based on eigen values. Principal component analysis provides total variance explained by each of the components. Varimax rotation is an orthogonal rotation technique used to avoid overlap of variance fields. This rotation converged in six iterations. Out of 20 indicators, the eigen value is found to be greater than one for only four components, which are the principal components explaining 85.155% of the total variance cumulatively.

Table 3: Factor loadings based on eigen values

Total variance explained (TVE) on employing principal component analysis and varimax rotation

	Initial Eigenvalues			Extraction Sum of Squared Loadings			Rotation Sums of Squared Loadings		
Component	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	9.999	49.995	49.995	9.999	49.995	49.995	9.37	46.836	46.836
2	3.064	15.320	65.316	3.064	15.32	65.316	2.85	14.247	61.083
3	2.349	11.744	77.060	2.349	11.744	77.060	2.690	13.452	74.535
4	1.619	8.095	85.155	1.619	8.095	85.155	2.12	10.620	85.155
5	0.994	4.969	90.124						
6	0.562	2.809	92.933						
7	0.527	2.633	95.566						
8	0.400	1.998	97.564						
9	0.229	1.147	98.711						
10	0.134	0.668	99.379						
11	0.069	0.345	99.724						
12	0.036	0.179	99.903						
13	0.010	0.048	99.951						
14	0.006	0.030	99.981						
15	0.004	0.018	100.000						
16	3.19E-16	1.60E-15	100.000						
17	2.75E-16	1.38E-15	100.000						
18	1.14E-16	5.69E-16	100.000						
19	1.02E-17	5.11E-17	100.000						
20	-4.38E-16	-2.19E-15	100.000						

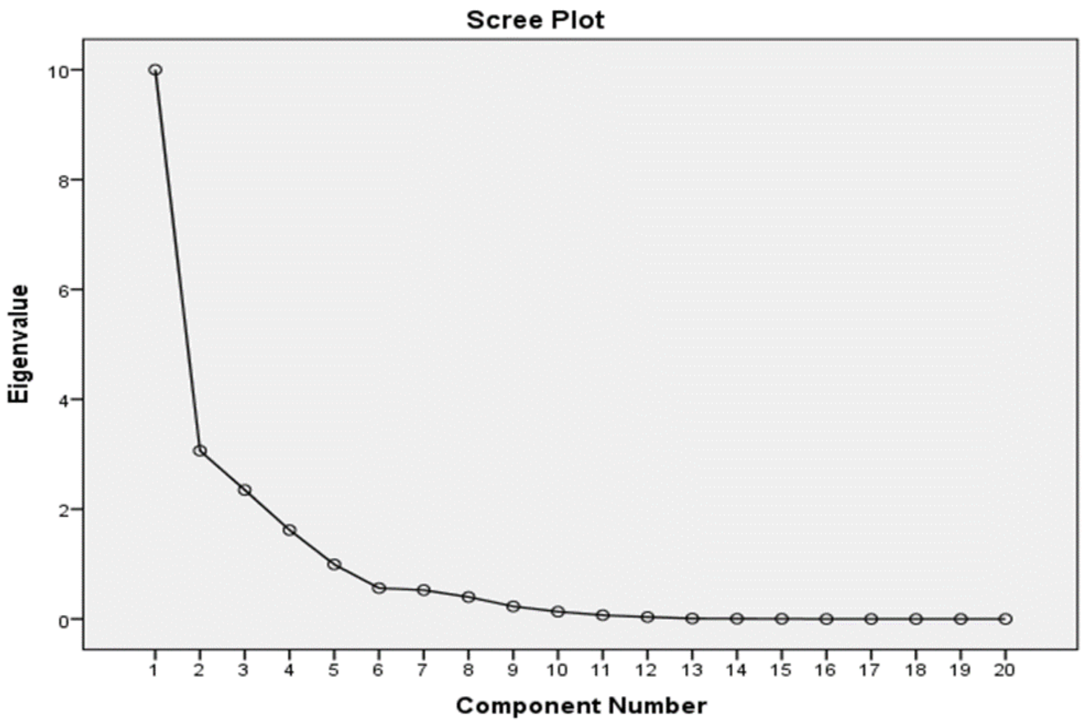

Fig. 5. *Graph depicting scree plot for selecting principal components*

The scree plot depicted in Fig. 5 above confirms the results of total variance explained (TVE). The scree test consists of eigenvalues and factors (Cattell, 1978). The number of factors to be retained are represented by the data points that have eigen values above the point where the downward slope of the curve is clearly leveling off. This point is called the point of inflexion. To determine this point of inflexion, researchers analyse the horizontal and vertical lines starting from each end of the curve. The scree test is only reliable when we have a sample size of at least 200. Since our sample set S consists of 1844 firms, scree plot is reliable. In situations where data points are clustered at the point of inflexion in the scree plot, one needs to rerun the analysis several times and manually set the number of factors to be extracted each time (Costello & Osborne, 2005). The decision on the number of factors that are to be retained is based on visual inspection of scree test.

The common factor analysis partitions total variance into common variance and unique variance. Table 4 presents the common variances, generally known as communalities. Initially, all indicators have common variance of 1.000 whereas there is variation in these values after extraction. In addition, we look at the results of the rotated component matrix presented in Table 5 to know the composition of these 4 components.

Table 4: Common variances

Communalities		
Variables	**Initial**	**Extraction**
GNPA	1.000	0.919
NNPA	1.000	0.978
GAS	1.000	0.938
CDR	1.000	0.847
CAR	1.000	0.780
GNPA/GAS	1.000	0.973
NNPA/GAS	1.000	0.982
GA/GDP	1.000	0.766
GPG	1.000	0.924
GFD	1.000	0.850
CPI	1.000	0.946
GST	1.000	0.920
ESD	1.000	0.886
NFDI	1.000	0.589
NFPI	1.000	0.562
FXR	1.000	0.923
PICD	1.000	0.732
PPCB	1.000	0.672
OSCB	1.000	0.980
TACB	1.000	0.865

Table 5: Rotated Component Matrix

Component				
Variables	**1**	**2**	**3**	**4**
GNPA	-0.751	-0.009	0.446	0.395
NNPA	-0.954	-0.016	0.174	0.193
GAS	0.956	0.014	0.093	0.122
CDR	0.258	0.071	0.850	0.230
CAR	-0.843	-0.074	0.243	0.068
GNPA/GAS	-0.904	-0.008	0.288	0.269
NNPA/GAS	-0.976	-0.012	0.102	0.136
GA/GDP	0.294	-0.684	-0.258	-0.380
GPG	0.123	0.927	-0.214	0.062
GFD	0.295	-0.579	-0.596	0.268
CPI	0.943	0.037	-0.236	0.010
GST	0.508	0.506	0.200	0.606
ESD	0.934	0.029	0.100	0.049
NFDI	0.214	0.694	-0.119	-0.218
NFPI	0.151	0.336	-0.633	-0.162
FXR	0.856	0.057	-0.430	-0.043
PICD	-0.081	-0.099	0.151	0.832
PPCB	0.626	-0.102	0.189	-0.483
OSCB	0.980	-0.005	-0.099	0.092
TACB	0.247	-0.548	0.579	-0.410

The communalities show individual R-squared values. This means it shows the proportion of variation accounted for by the selected components. The ideal acceptable values are above 0.7. We observe that all the extraction values are above 0.7, except for three factors, namely NFDI, NFPI and PPCB. The rotated component matrix comprises Pearson correlations between indicators and components. These are known as factor loadings and allow us to interpret traits reflected by our components. The acceptable value of factor loading is above 0.5. We observe that seven indicators in component 1, three indicators from component 2, two indicators from component 3 and one indicators from component 4 are acceptable based on their Pearson correlations. The results of exploratory factor analysis confirm that our indicators are relevant to the theoretical constructs.

First-Order Model

Due to complexity in grouping the indicators into a single component, we perform partial structural modelling to establish unidirectional causality between variables through path models. The measurement models and structural model are examined using confirmatory factor analysis (CFA) and path analysis on SmartPLS. A pre-run model is shown in Fig. 6.

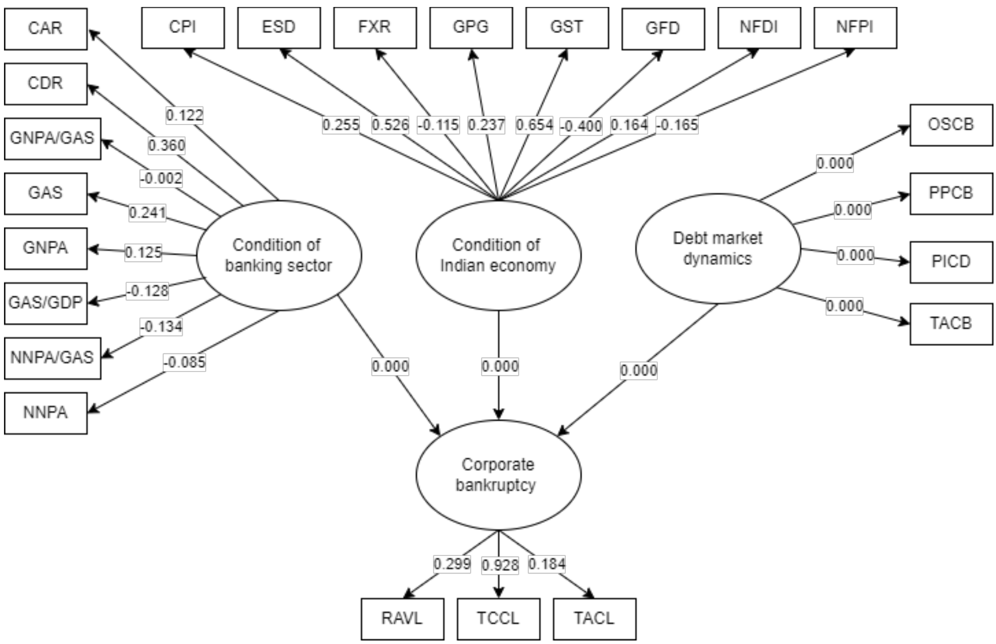

Fig. 6. *Pre-run model*

We observe that the indicators of the independent variable construct of debt market dynamics do not have a significant role in the inner as well as the outer models. Therefore, we discard all the measured variables and the construct of debt market dynamics to avoid biasedness in estimation. This is followed by re-running the model on SmartPLS. Fig. 7 displays the first-order model obtained. The negative co-variances were deleted from this model thus reducing its dimensionality.

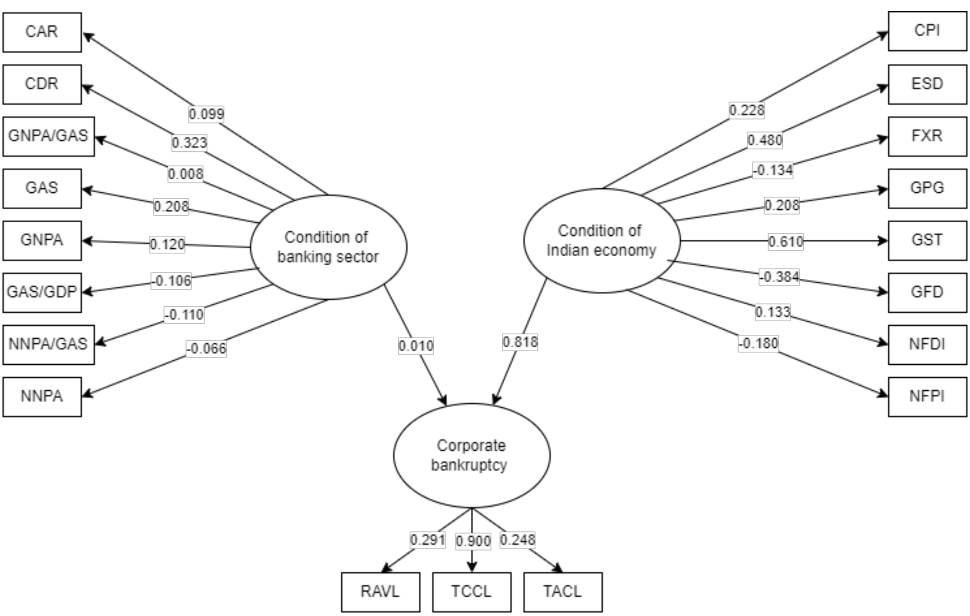

Fig. 7. *First-order model*

Second-Order Model

We observe that the reduction in dimensionality of the model based on negative co-variances improved the estimation accuracy. For the construct of condition of the banking sector, GAS/GDP, NNPA/GAS and NNPA were discarded. For the construct of condition of the Indian economy, FXR, GFD and NFPI were discarded. This leaves us with 10 indicators of independent variable constructs and three indicators of dependent variable construct. The second-order model is displayed in Fig. 8. A critical observation in this model is that CDR, ESD and TCCL have significant and highest covariances with their respective constructs. We can infer from this that CDR and ESD play a key role in unidirectionally causing TCCL. However, the generally acceptable levels of covariances for significance is any value above 0.50. Therefore, we reduce indicators with unfavourable covariances and re-run the model using SmartPLS to obtain the third-order model.

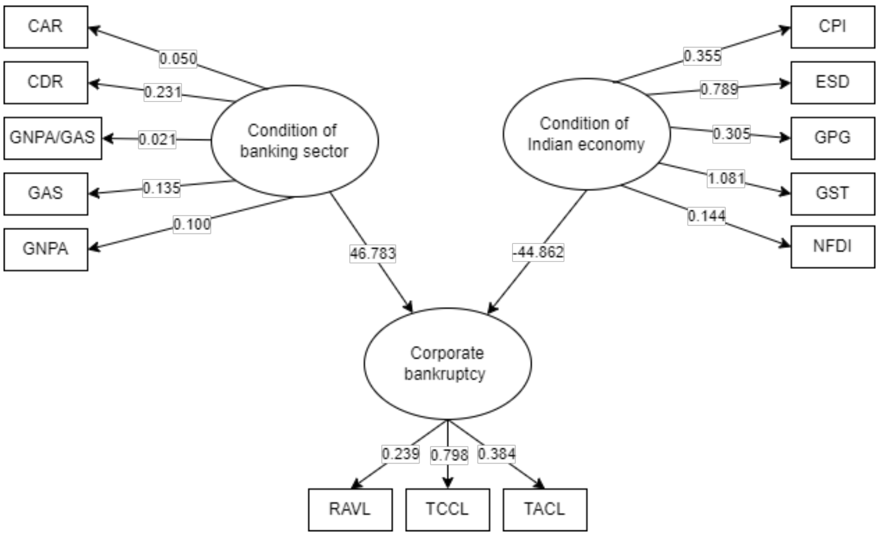

Fig. 8. *Second-order model*

Third-Order Model

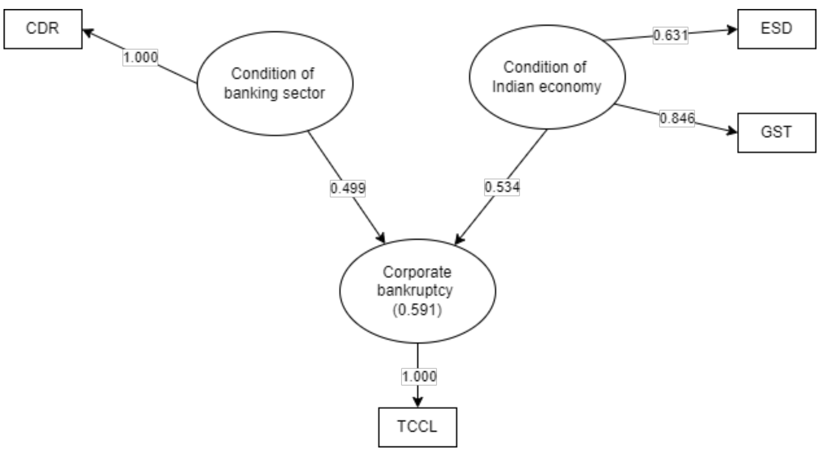

Fig. 9. *Third-order Model*

Fig. 9 above shows the third-order model that emerged on recursively running the model. In this model, the condition of the banking sector is indicated entirely by CDR. Condition of the Indian economy is indicated by ESD and GST. Corporate bankruptcy is indicated entirely by TCCL.

Table 6: Model Fit Summary

	Saturated model	Estimated model
SRMR	0.066	0.066
d_ULS	0.044	0.044
d_G	0.030	0.030
Chi-square	2.297	2.297
NFI	0.872	0.872

Table 7: R-squared Matrix

	R-squared	Adjusted R-squared
Corporate Bankruptcy	0.591	0.529

Table 7 shows that the SRMR (Standardised Root Mean Square Residual) value is 0.066. A value less than 0.08 is considered a good fit (Hu & Bentler, 1999; Cho et al. 2020). Besides, the NFI (Normed Fit Index) value is 0.87. NFI ranges from 0 to 1 and a value closer to 1 is considered a good fit (Bentler and Bonett, 1980). Both the values suggest that our model is a good fit. Table 9 shows the R-squared (coefficient of determination) and adjusted R-squared. Both are explaining more than 50% of the variance.

Table 8: Construct reliability and validity

Constructs	Cronbach alpha	rho_A	Composite reliability	AVE
Corporate Bankruptcy	1.000	1.000	1.000	1.000
Condition of banking sector	1.000	1.000	1.000	1.000
Condition of Indian economy	0.696	0.737	0.711	0.557

Table 9 reports the internal consistency of the model through the values of Cronbach's Alpha, Composite Reliability and Average Variance Extracted (AVE). AVE is a measure of convergent validity and all the values of AVE in the results are acceptable as. The value of Cronbach's Alpha is acceptable as all values are above 0.7 except for condition of the Indian economy in which it is almost close to 0.7. Table 9 reports the external consistency through the Discriminant Validity measured using Fornell-Larcker Criterion (1981). In this case, the diagonal values should be larger than all the values in the respective row. Our results satisfy this criterion.

Table 9: Discriminant validity by Fornell-Larcker criterion

Fornell-Larcker Criterion	Corporate bankruptcy	Condition of banking sector	Condition of Indian economy
Corporate bankruptcy	1.000		
Condition of banking sector	0.557	1.000	
Condition of Indian economy	0.588	0.109	0.746

Table 10: Discriminant validity by Heterotrait-Monotrait (HTMT) Ratio			
HTMT Ratio	**Corporate bankruptcy**	**Condition of banking sector**	**Condition of Indian economy**
Corporate bankruptcy	1.000		
Condition of banking sector	0.557	1.000	
Condition of Indian economy	0.594	0.217	1.000

Some studies have found that Fornell-Larcker criterion lacks in establishing the distinctiveness between constructs (Henseler, 2015). For this reason, we used another measure of Heterotrait–Monotrait (HTMT) for assessing the discriminant validity. The threshold of HTMT values as described in the literature should be less than 0.85 in case of very conservative threshold (Gold et al., 2001). However, many authors have suggested that HTMT values below 0.9 are acceptable (Henseler, Ringle, & Sarstedt, 2015). Our results are very well satisfying this criterion.

Table 11: Collinearity statistics	
Variables	**VIF**
CDR	1.000
ESD	1.399
GST	1.399
TCCL	1.000

Table 11 checks for the issue of multicollinearity by using Variance Inflation Factor (VIF). Although a VIF less than 10 is considered to be acceptable, we adopt a conservative approach by saying that VIF less than 5 suggests that there exists no multicollinearity. Our results satisfy this criterion too.

Table 12: Path coefficients			
	Corporate bankruptcy	**Condition of banking sector**	**Condition of Indian economy**
Corporate bankruptcy			
Condition of banking sector	0.499		
Condition of Indian economy	0.534		

A path coefficient evaluates the causal model by indicating the relationships between dependent variable (DV) construct and independent variable (IV) constructs. Path coefficient is also known as Connection Strength and it represents the response of the DV to a unit change in IV (Bollen, 1989). The results suggest that corporate bankruptcy is positively correlated with condition of banking sector and condition of Indian economy. The results suggest here would be almost 50% variation in corporate bankruptcy variable for a unit change in respective independent variables.

The above detailed analysis shows that the bankruptcy trend is influenced only by three factors - CDR (for Condition of Banking Sector); ESD and GST (for Condition of Indian Economy). Although many indicator variables were taken into account for analysis, the PLS-SEM pruned back to only these three variables. Path analysis showed that there is a positive correlation between each of the constructs and our dependent variable. So, whenever there is an improvement in the condition of banking sector (increase in credit to deposit ratio), there is an increasing trend of corporate bankruptcy. A higher CDR suggests an overstretched balance sheet and may also indicate capital adequacy issues. Companies going bankrupt usually have a higher level of external debt (Schwarz and Martin, 2017). In an uncertain economic environment, the level of financial distress is found to be positively related with the avoidance of tax (Richardson et.al. 2015). This tax avoidance signals the decline in businesses during a crisis which acts as a factor of failure in debt obligation as shown in our results.

CONCLUSION

To conclude, our study is unique in three ways. Firstly, the approach used in establishing causal relationship has not been used before in the context of Indian bankruptcy regime. Secondly, our study is posited at half-a-decade lifespan of the new Indian bankruptcy regime. This provides us a decent period for carrying out an exhaustive study based on data availability to draw meaningful conclusions. Thirdly, our study has important economic and policy implications for future bankruptcy reforms in India in an evolving ecosystem. This study explicitly points out that the first five years of IBC have been replete with liquidations caused predominantly by unfavourable credit-deposit ratio (from variables associated with condition of banking sector), external sector debt and indirect taxes collection (from variables associated with condition of Indian economy). Although debt market dynamics facilitate the credit availability and access to credit, it is found to be irrelevant in determining the corporate bankruptcy trend in India. Endogenously, the corporate bankruptcy trend is significantly explained by the total admitted claims during CIRP ending with the order of liquidation.

This study reveals aggregate-level factors affecting the corporate bankruptcy trend in India. We used recursive PLS-SEM approach to establish unidirectional causality between dependent and independent variable constructs. The combined effect of banking sector and Indian economy was accounted for to formulate corporate bankruptcy trend. This upward-sloping trend is 80% constituted of the liquidation channel of admittance to CIRP. The remainder 20% is constituted of the liquidation channel of dissolution processes. Both, freedom to enter and exit business, are equally important factors for economic growth. Identification of the explicit factors that can affect the freedom of exit can have important practical implications for reforming the existing insolvency regime. An increasing bankruptcy (liquidation) trend is not a good sign for the economy as it reflects value destruction. At the same time, an efficient insolvency regime can save the value of a firm by recovering most assets at minimum cost. According to the discontinued ease of doing business reports by the World Bank, indicators for insolvency regime were not very favourable for India. This study drew mileage from it to investigate these less studied but crucial factors.

Our study attempts to resolve the issue of key identifiers for enhancing efficiency of the existing insolvency regime in three aspects. First, credit to deposit ratio of banks is a major indicator for credit flow in the economy, particularly for a bank-based economy like India. It reflects bank lending capacity that gets manifested as investment money multiplier. Having emerged as one of the major indicators for corporate bankruptcy trend, a higher CDR indicates multiple bank-specific issues such as inadequate capitalisation, myopic growth trap and balance sheet imbalances. Prudent regulatory norms directed towards the banking sector and credit market can ameliorate this distress. Second, indirect tax collection can play a key role in framing a reformed bankruptcy ecosystem. It is generally observed that firms facing higher level of financial distress possess tax avoidance history. This aspect can be tapped into for arresting cases by marking it as an early warning signal and rescuing companies at an earlier stage. Third, a higher external sector debt reinforced by recent trends of depreciation of rupee increases the bankruptcy risk and affects the balance of payments of the country. Cross-border obligations are difficult to meet in an uncertain environment marred by fiscal imbalances. Such a situation requires resolve for economy-wide corrections such as export promotion, capital convertibility and institutional productivity. The government of the day has shown intention in this direction by undertaking recent initiatives such as creation of bad bank, National Asset Reconstruction Company Ltd (NARCL) and India Debt Resolution Company Ltd (IDRCL). However, the effectiveness of these institutions is an agenda for future deliberations. Additionally, amendments in IBC and incentivisation of Asset reconstruction companies (ARCs) are necessary but not sufficient to functionalise a flamboyant bankruptcy ecosystem. The report recently submitted by Sudarshan Sen Committee on ARCs has to be studied deeply in this context for gainful insights.

Our study can motivate policymakers, practitioners and researchers to explore transmission of macroeconomic variability to the firm level and to examine its relationship with credit cycles. However, it suffers from certain limitations. Firstly, data availability for micro-level variables is an issue of contention for encapsulating measures of administrative efficiency. For example, data for number of pending court cases, daily case load of judges and idle time of cases in NCLT and National Company Law Appellate Tribunal (NCLAT) are unavailable. Secondly, a higher granularity of data helps to operationalise a better model with a greater number of datapoints. Thirdly, the time period of our study is limited to 16 quarters only. A greater study period helps in accounting for greater variability in the financial system for robust results. Future scope of research lies in examining the consequences of the significant factors identified in our study. For instance, an exogenous shock of one-in-a-century pandemic forced suspension of CIRP due to the possibility of admittance of invalid cases. Stimulus package by government, moratorium on loan payments and emergency credit lines worked as mediator for reducing CIRP cases. Regardless of the situation, it is highly doubtful whether evergreening of loans and support to non-competitive firms will lead to spike in number of cases getting admitted to CIRP. It is therefore a fodder for future researchers to investigate the speculation around insolvency cases.

1 Jakovljevi, S. et al. (2015), "A Review of Empirical Research on the Design and Impact of Regulation in the Banking Sector", pp. 423–443.

2 Dhar S. (2019), "Corporate Debt: the catalyst for the next crisis in India?", Committee for the Abolition of Illegitimate Debt.

3 The Financial Stability Report, December, 2021.

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5 Address delivered by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India, April 30, 2022 in the International Research Conference on Insolvency and Bankruptcy held at IIM Ahmedabad, "Resolution of Stressed Assets and IBC".

6 Speech delivered by Dr. Viral V. Acharya, Deputy Governor, Reserve Bank of India on February 21, 2017 at the Indian Banks' Association Banking Technology Conference, Hotel Trident, Nariman Point, Mumbai.

7 Speech delivered by Urjit R. Patel at the Inaugural session of the "National Conference on Insolvency and Bankruptcy: Changing Paradigm" at Mumbai, August 19, 2017.

8 The Insolvency and Bankruptcy Code, 2016.

9 Reddy Y.V., "Issues and challenges in the development of the debt market in India", BIS Papers No.11.

10 In addition to the capital structure theories and perspectives mentioned, see Harris & Raviv, 1991.

11 For more information on EFA, refer Fabrigar & Wegener (2011) and Watkins (2018).

12 First generation methods include multiple regression and ANOVA techniques.

13 For more information on PLS-SEM, refer Haenlein & Kaplan (2004) and Latan & Ramli (2013)"mendeley": "formattedCitation":" Latan & Ramli, 2013.

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25

FACTORS IDENTIFYING THE PREPACKAGED INSOLVENCY REGIMES AMONG MSMEs

— P Vamsi Krishna and T. Sreenivas

Executive Summary

The changes brought about by the COVID-19 pandemic have forced governments across the world to introduce measures to protect their economy and small businesses. The main aim behind the introduction of the prepack was to provide an alternative insolvency resolution process to the bankrupt micro, small, and medium enterprises (MSMEs). This paper highlights surveys and identifying the critical factors of MSME insolvency which are complex insolvency systems, credit behavior, lack of information about MSME debtors, post-insolvency financing, insufficient assets to fund a formal insolvency procedure. Using multiple regression analysis, the paper identifies that complex insolvency system was negatively supported due to pre COVID-19 insolvency regimes and post COVID-19 insolvency regimes are different. However, the factor credit behavior was positively supported since the lenders with security interests prefer to enforce their claims outside of the insolvency system. Finally, suggesting the pre-packs are seen to be a viable alternative to the current corporate insolvency resolution process (CIRP), significantly less time consuming and inexpensive as against the formal insolvency proceedings.

Keywords: Prepack, MSME, Bankruptcy, Insolvency Resolution, Mechanism, Factor Analysis, Multiple Regression

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC / Code) is an Indian law which creates a consolidated framework that governs insolvency and bankruptcy proceedings for companies, partnership firms, and individuals. Prior to the IBC, the legislative framework for insolvency and restructuring was fragmented across multiple legislations, such as the Companies Act 2013, the Sick Industrial Companies (Special Provisions) Act, 1985, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act), and others.

Creating opportunities for MSMEs in emerging markets is a keyway to advance economic development and reduce poverty. The challenge of unsettled disputes post suspension of parts of the IBC in 2020 will need to be addressed to effectively tackle the problem of rising non-performing assets (NPAs).

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 highlighted that-

> MSMEs are critical for India's economy as they contribute significantly to its gross domestic product and provide employment to a sizeable population;
>
> and it is considered necessary to urgently address the specific requirements of MSMEs relating to the resolution of their insolvency due to the unique nature of their businesses and simpler corporate structures.

The Government has amended the IBC to provide for pre-packaged insolvency resolution process (PPIRP) for MSMEs through promulgation of the Ordinance. The alternative insolvency resolution framework was expected to bring about a quicker and more cost-effective process for MSMEs that would maximise value while being least disruptive to the business.

BACKGROUND

The pandemic and the lockdowns have inflicted heavy losses on sales and incomes of many businesses- big or small, formal or informal. Consequently, many companies and enterprises are finding it difficult to meet their contractual obligations. Therefore, the number of disputes between debtors and creditors is bound to explode. Already there are reports of borrowers expressing inability to service the debt. Many employers have refused the promised wages and employment benefits, consequently triggering litigation by the counterparties for compensation.

Slow progress in the resolution of distressed companies has been one of the key issues raised by creditors regarding the corporate insolvency resolution process under the IBC. However, pre-pack has shown the ray of hope to the creditors of MSMEs. Pre-packs allow the maximisation of the value of assets by providing a faster resort to a resolution plan in consultation with the stakeholders. Pre-packs also increase the investors' confidence. Pre-packs are seen to be a viable alternative to the current corporate insolvency process and would be significantly less time-consuming and inexpensive as against the formal insolvency proceedings. Pre-packs allow the maximisation of the value of assets by providing a faster resort to a resolution plan in consultation with the stakeholders. MSMEs are critical to the supply chain and are hit hard due to supply chain disruptions caused by the pandemic. Our aim is to save these micro, small and medium units. So, this paper identifies the critical factors affecting prepackaged insolvency regimes. There is a need to discuss the outcomes in the post COVID-19 world for different stakeholders including MSMEs, employees and banks. Finally offering suggestions for reducing litigation and mitigating the adverse effects of the pandemic.

OBJECTIVES OF THE STUDY

This research attempts to find the relationship between independent variables i.e. complex insolvency system, credit behavior, post insolvency financing, insufficient assets to fund a formal insolvency procedure, lack of information about MSME debtors and the dependent variable initiation of bankruptcy and insolvency proceedings.

HYPOTHESES OF THE STUDY

H_1: There is a significant relationship between complex insolvency system and initiation of bankruptcy and insolvency proceedings.

H_2: There is a significant relationship between credit behavior and initiation of bankruptcy and insolvency proceedings.

H_3: There is a significant relationship between post insolvency financing and initiation of bankruptcy and insolvency proceedings.

H_4: There is a significant relationship between insufficient assets to fund a formal insolvency procedure and initiation of bankruptcy and insolvency proceedings.

H_5: There is a significant relationship between lack of information about MSME debtors and initiation of bankruptcy and insolvency proceedings.

MSME CLASSIFICATION

Table 1 gives the classification of enterprises into MSME based on their investment in plant and machinery / equipment, and annual turnover.

Table 1: MSME Classification

Criteria	Micro	Small	Medium
Investment in plant and machinery / equipment	Not more than ₹ 1 crore.	Not more than ₹ 10 crore.	Not more than ₹ 50 crore.
Annual turnover	Not more than ₹ 5 crore.	Not more than ₹ 50 crore.	Not more than ₹ 250 crore.

METHODOLOGY OF THE STUDY

In view of the problem and scope of the study, the judgmental sampling technique is adopted in drawing the sample. So, in this connection, middle level managers of various 117 textile MSMEs have given their response. However, 44 managers have responded. The demographic profile of the respondents is as follows.

Table 2: Demographic Profile of the Respondents:

Sl. No	Characteristics	Items	Percent	Frequency
1	Manager's Age	Upto 25 Years	10.60%	5
		26-40 Years	36.10%	16
		41-55 Years	53.30%	23
2	Gender	Male	62.1%	27
		Female	37.9%	17
3	Manager's Experience	1-5 Years	39.40%	17
		6-10 Years	33.20%	15
		>10 Years	27.40%	12
4	No of Subordinates directly report to the Owner	1-10	62.6%	28
		11-20	37.40%	16
5	Manager Working Position	Line Manager	73.4%	32
		Junior Manager	26.6%	12
6	Manager's Highest level of Education	SSC	4.4%	2
		ITI	32.8%	14
		Diploma	36.2%	16
		Intermediate	6.1%	3
		Bachelor's Degree	11.2%	5
		Master's Degree	9.3%	4

The primary objective of introducing pre-pack for MSMEs is that it is a cost effective mechanism and quickens the process for resolution of MSMEs.

The Government has amended the IBC to provide for prepackaged resolution framework for MSMEs through promulgation of an ordinance. The alternative insolvency resolution framework was expected to bring about a quicker and more cost-effective process for MSMEs that would maximise value while being least disruptive to the business.

Due to a variety of factors, including lack of advice, low bargaining power, reduced size and lack of viability, financially distressed MSMEs usually face more problems having access to new financing. Therefore, the underinvestment problems potentially generated in a situation of insolvency can be exacerbated in the context of MSMEs.

Table 3: Descriptive Statistics (Independent variables)

	Mean	Std. Deviation	Analysis N
Our Company faces several issues and challenges	3.59	1.041	44
Our Company faces severe financial distress	3.55	0.951	44
Our Company struggles to understand the complex formal procedures	3.55	0.951	44
Our Company has few incentives to deal with MSME debtors through legal processes	3.98	0.821	44
Our Company often faces creditor passivity due to the amount of time, money and effort requires	3.68	0.934	44
Our Company possesses the secured creditors focus on enforcement of security	3.84	0.776	44
Our Company rely on family and friends for help	3.41	1.064	44
Our Company often lack the resources to cover the costs and fees for a formal insolvency procedure	3.36	1.036	44
Our Company lacks the access to equity capital	3.41	1.041	44
Our Company may lack funds to cover the expenses of an insolvency process	3.25	0.781	44
Our Company fails to generate an expectation for unsecured creditors to receive any returns	3.25	0.991	44
Our Company financed with a mixture of corporate debt and personal debt	3.84	0.914	44
Our Company fails for severe consequences for the entrepreneur and including social stigma	3.73	0.899	44
Our Company lacks the good records regarding management	3.66	0.888	44

Table 4: Descriptive Statistics: Dependent Variable

	Mean	Std. Deviation	Analysis N
Our company understands the significance of collateral requirements	3.77	0.831	44
Our company knows the rehabilitation of distressed enterprises	3.98	0.849	44
Our company scales the inability to downsize operations efficiently	3.89	0.841	44

KMO statistic varies between 0 and 1. Kaiser 1974 recommends accepting values greater than .5 as barely acceptable. KMO values of less than .5 should lead to more data collection or choosing variables to include.

Table 5: Communalities

Description	Initial	Extraction
Our Company faces several issues and challenges	1.000	0.829
Our Company faces severe financial distress	1.000	0.827
Our Company struggles to understand the complex formal procedures	1.000	0.689
Our Company has few incentives to deal with MSME debtors through legal processes	1.000	0.434
Our Company often faces creditor passivity due to the amount of time, money and effort requires	1.000	0.785
Our Company possesses the secured creditors focus on enforcement of security	1.000	0.582
Our Company rely on family and friends for help	1.000	0.694
Our Company often lack the resources to cover the costs and fees for a formal insolvency procedure	1.000	0.752
Our Company lacks the access to equity capital	1.000	0.747
Our Company may lack funds to cover the expenses of an insolvency process	1.000	0.731
Our Company fails to generate an expectation for unsecured creditors to receive any returns	1.000	0.700
Our Company financed with a mixture of corporate debt and personal debt	1.000	0.731
Our Company fails for severe consequences for the entrepreneur and including social stigma	1.000	0.689
Our Company lacks the good records regarding management	1.000	0.530

Extraction Method: Principal Component Analysis.

Table 6: Dependent Variable -Communalities

Description	Initial	Extraction
Our company understands the significance of collateral requirements	1.000	0.576
Our company knows the rehabilitation of distressed enterprises	1.000	0.531
Our company scales the inability to downsize operations efficiently	1.000	0.608

Extraction Method: Principal Component Analysis.

Table 7: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.589	18.495	18.495	2.589	18.495	18.495	2.425	17.320	17.320
2	2.341	16.724	35.218	2.341	16.724	35.218	2.212	15.798	33.117
3	1.756	12.542	47.760	1.756	12.542	47.760	1.798	12.843	45.960
4	1.604	11.454	59.215	1.604	11.454	59.215	1.667	11.905	57.865
5	1.429	10.209	69.424	1.429	10.209	69.424	1.618	11.558	69.424
6	0.909	6.493	75.917						
7	0.733	5.233	81.150						
8	0.716	5.113	86.263						
9	0.495	3.538	89.801						
10	0.474	3.388	93.189						
11	0.381	2.718	95.907						
12	0.246	1.759	97.665						
13	0.211	1.510	99.176						
14	0.115	0.824	100.000						

Extraction Method: Principal Component Analysis.

Table 8: Rotated Component Matrix

	Component				
	1	2	3	4	5
Our Company faces several issues and challenges	0.892				
Our Company faces severe financial distress	0.876				
Our Company struggles to understand the complex formal procedures	0.818				
Our Company often lack the resources to cover the costs and fees for a formal insolvency procedure		0.863			
Our Company lacks the access to equity capital		0.835			
Our Company rely on family and friends for help		0.791			
Our Company often faces creditor passivity due to the amount of time, money and effort requires			0.870		
Our Company possesses the secured creditors focus on enforcement of security			0.661		
Our Company has few incentives to deal with MSME debtors through legal processes			0.615		
Our Company may lack funds to cover the expenses of an insolvency process				0.830	

	Component				
	1	2	3	4	5
Our Company fails to generate an expectation for unsecured creditors to receive any returns				0.786	
Our Company financed with a mixture of corporate debt and personal debt					0.797
Our Company fails for severe consequences for the entrepreneur and including social stigma					0.772
Our Company lacks the good records regarding management					0.526

Extraction Method**:** Principal Component Analysis.

Rotation Method**:** Varimax with Kaiser Normalisation.

a. Rotation converged in 5 iterations.

ANALYSIS

Independent Variables

(a) ***Factor 1: Complex insolvency system:***

It highlights about issues, challenges, financial distress and complex formal procedures.

(b) ***Factor 2: Post insolvency financing***

It highlights about lack the resources to cover the costs; lacks for equity capital rely on family and friends for help.

(c) ***Factor 3: Credit Behavior***

It highlights about creditor passivity, enforcement of security, few incentives to deal with MSME debtors through legal process.

(d) ***Factor 4: Insufficient assets to fund a formal insolvency procedure***

It highlights about the company lacking the funds to cover the expenses of an insolvency process and also highlights about the company fails to generate an expectation for unsecured creditors.

(e) ***Factor 5: Lack of information about MSME debtors***

It highlights about the lack of information about personal and corporate debt, the company lacks the good records regarding management.

Dependent variable

(a) ***Factor 1: Initiation of insolvency and bankruptcy proceedings***

It highlights about the collateral requirements, rehabilitation of distressed enterprises, inability to downsize the operations efficiently.

Multiple Regressions

Table 9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.490[a]	0.240	0.140	0.92736448

a. **Predictors:** (Constant), REGR factor score 5 for analysis 1, REGR factor score 4 for analysis 1, REGR factor score 3 for analysis 1, REGR factor score 2 for analysis 1, REGR factor score 1 for analysis

Table 10: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	10.320	5	2.064	2.400	.055[b]
	Residual	32.680	38	.860		
	Total	**43.000**	**43**			

a. **Dependent Variable:** REGR factor score 1 for analysis 2

b. **Predictors:** (Constant), REGR factor score 5 for analysis 1, REGR factor score 4 for analysis 1, REGR factor score 3 for analysis 1, REGR factor score 2 for analysis 1, REGR factor score 1 for analysis 1

Table 11: Coefficients

Model		Unstandardised Coefficients		Standardised Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	5.359E-17	0.140		0.000	1.000		
	Complex insolvency system	-0.298	0.141	-0.298	-2.110	0.042	1.000	1.000
	Post insolvency financing	-0.005	0.141	-0.005	-0.038	0.970	1.000	1.000
	Credit Behavior	0.285	0.141	0.285	2.017	0.051	1.000	1.000
	Insufficient assets to fund a formal insolvency procedure	0.121	0.141	0.121	0.852	0.399	1.000	1.000
	Lack of Information about MSME debtors	-0.235	0.141	-0.235	-1.659	0.105	1.000	1.000

a. **Dependent Variable:** Initiation of insolvency and bankruptcy proceedings.

Table 9 highlights that R square is 24%. Since the significance value is <0.1, therefore the F value is 2.4. However, it shows that two factors are supported to the dependent variable.

First factor 1: complex insolvency system was negatively supported. i.e.: significance <0.05 and its value is -.298, it shows that pre COVID-19 insolvency regimes and post COVID-19insolvency reigmes are different. At the time of writing, the liquidity and solvency challenges triggered by the COVID-19 pandemic are expected to give rise to a wave of bankruptcy filings across the globe. The lockdown and social distancing measures that are urgently needed to contain the pandemic have disrupted business activity and their ability to pay creditors. Optimal insolvency regimes are accordingly critical to facilitate the rescue of viable businesses and the efficient liquidation and market exit of non-viable businesses. On the other hand, weak insolvency regimes, can push viable enterprises into non-viability through lengthy and overly complex restructuring procedures or lead to the proliferation of zombie firms that leach productive resources from the market and the challenges highlight about the need for accurate information; lack of understanding of IBC and objectives creditors may not fully understand the implications of the moratorium provisions and seek to recover money from their account after the insolvency commencement date. Complex insolvency systems that deter MSMEs form resorting to formal procedures to deal with their financial distress.

Prior to entering an insolvency proceeding, many MSMEs are disadvantaged because they lack the sophistication to identify and react to financial distress. This may result in MSMEs waiting too long before initiating the insolvency process. This problem is particularly acute for MSMEs given the limited incentives they have for starting a complex and burdensome proceeding. Also, the social barriers and reputational stigma associate with the insolvency system may discourage MSME representatives from resorting to formal insolvency proceedings. When insolvency is imminent, debtors should have greater regard to the interest of creditors and should attempt to address the distress situation.

Many countries around the world have implemented, or are planning to implement, insolvency frameworks for MSMEs. Jurisdictions with specific insolvency rule for MSMEs. Other countries have adopted or are planning to adopt simplified insolvency frameworks as a response to the COVID-19 pandemic. In some jurisdictions, the reforms are expected to be implemented temporarily while the other countries adopted a simplified insolvency framework for MSMEs permanently.

Similarly, the Factor 3: highlights about credit behavior was positively supported to the initiation of bankruptcy and insolvency proceedings with a significance <0.1 and with Beta value of 0.285. It highlights about the lack of participation of creditors in insolvency proceedings of MSMEs either because they are non-sophisticated creditors without the knowledge and resources to be part of the process or because they are lenders with security interests, and they prefer to enforce their claims outside of the insolvency system.

However, the rest of the factors are not supported to the dependent variable from the Table 11.

SUGGESTIONS

(a) Central Government should ensure adequate protection for the pre-pack provisions were not misused by errant promoters.

(b) Pre-packs are largely aimed at providing MSMEs with an opportunity to restructure their liabilities and start with a clean state while still providing adequate protections so that the system is not misused by firms to avoid making payments to creditors.

(c) When a company goes into distress, speed is crucial to improve the chances of its turnaround as a going concern. The Government should consider setting up the specific benches of the National Company Law Tribunal to deal with pre-pack resolution plans to ensure that they are implemented in a time bound manner.

(d) In case of pre-packs, the incumbent management retains control of the company until a final agreement is reached. Pre-packs would mostly be used for businesses that are running, the investors would likely need to maintain good relations with operational creditors.

(e) The following are the steps to implement PPIRPs:

  (i) Pre-commencement requirements

  (ii) Admission of application for initiating pre-package process

  (iii) Conduct of the pre-pack process

  (iv) Consideration and approval of resolution plans

  (v) Closure of process

CONCLUSION

The Government is in the process of finalising regulations for fast-track resolution under the IBC. Mature small, medium and new knowledge-based enterprises in the sector are mostly structured as private limited or public limited companies.

Since the majority of MSMEs facing insolvency are more likely to liquidate and not go into reorganisation/restructuring, frameworks should not only focus on reorganisation/restructuring, but also on expeditious liquidation mechanisms. Firstly, behavioral change on part of the debtors to ensure sound business decision making and prevent business failures is encouraged. Secondly, it envisages a process through which financially ailing corporate entities are put through a rehabilitation process and brought back up on their feet.

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Appendix

(a) Questionnaire

Complex insolvency systems

Our Company faces several issues and challenges

Our Company faces severe financial distress

Our Company struggles to understand the complex formal procedures

Credit Behavior

Our Company has few incentives to deal with MSME debtors through legal processes

Our Company often faces creditor passivity due to the amount of time, money and effort requires

Our Company possesses the secured creditors focus on enforcement of security.

Post insolvency financing

Our Company rely on family and friends for help

Our Company often lack the resources to cover the costs and fees for a formal insolvency procedure

Our Company lacks the access to equity capital

Insufficient assets to fund a formal insolvency procedure

Our Company may lack funds to cover the expenses of an insolvency process

Our Company fails to generate an expectation for unsecured creditors to receive any returns

Lack of information about MSME debtors

Our Company financed with a mixture of corporate debt and personal debt

Our Company fails for severe consequences for the entrepreneur and including social stigma

Our Company lacks the good records regarding management

Initiation of insolvency and bankruptcy proceedings

Our company understands the significance of collateral requirements

Our company knows the rehabilitation of distressed enterprises

Our company scales the inability to downsize operations efficiently

(b) Literature Review:

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IBC – BUILDING THE ROAD TO PERFECTION?

— *Prakhar Sharma*

Executive Summary

As debt markets mature and creditor base is broadened a hybrid approach of insolvency resolution viz. 'creditor-in-control' along with 'debtor-in-possession' may have to be adopted under the Insolvency and Bankruptcy Code, 2016 (IBC/ Code), from its current 'creditor-in-control' approach.

The next level of resolution will be early detection of stress by use of artificial intelligence for analysing credit information databases comprising banking / other credit information of debtors. The administration of corporate insolvency resolution process (CIRP) can be further strengthened by providing protection to minority creditors as also operational creditors through further amendments. The valuation benchmarking for resolving stressed assets as a 'going concern' needs to be aligned with 'fair value'/ 'market value' rather than 'liquidation value'.

The way forward lies in establishment of secondary market for stressed loans with a greater number of participants to optimise capital and create more opportunities for resolution of stressed assets.

Keywords: Hybrid Approach, Creditor-In-Control, Debtor-In-Possession, Credit Information, IBC, Early Detection of Stress.

INTRODUCTION

The IBC has been a milestone to reckon in the country's journey towards the resolution of stressed assets. It is rapidly evolving into a comprehensive and mature Code, providing a holistic resolution to stress in entities including corporates, non-banking financial companies (NBFCs), medium and small enterprises (MSMEs), resolution to group insolvencies, cross-border insolvencies and the list is growing every day.

A testimony to the success of IBC is the Economic Survey of 2020-21, placing IBC as the best mode of recovery (average recovery of about 39%) for the banks, when pitted against others like Debt Recovery Tribunals, or the Lok Adalats etc. In fact, since its inception,[1] a total of 4708 CIRP have commenced, out of which CIRPs closed as withdrawn or resolved constitute 1649 cases against 1419 cases, which have ended in orders for liquidation.

Having said that, is it then time to celebrate? To answer to that question, one needs to do a deeper dive into the numbers. The average recovery (39%) through IBC, includes some really large resolutions (likes of Essar Steel, Bhushan Steel or Binani Cement), which were way higher in terms of recovery value, in comparison to most of the other resolutions. Also, overall 47% of the total CIRPs have ended up in commencement of liquidation against 14% resolved by means of a successful approval of the resolution plan. The ratio of liquidation to resolution thus stands at about 3:1.

Perhaps that's why the legislature, judiciary and of course the regulator viz. the Insolvency and Bankruptcy Board of India (IBBI) are working tirelessly towards improving the IBC model continuously.

With that background, this paper attempts to analyse the nature of the Code itself and the role of key players in the resolution process, along with a comparison of best practices of insolvency and bankruptcy laws in the US and the UK, with a view to further strengthen the Code. The paper discusses the future of the Code and its importance in resolving stress as India's economy continues to grow leaps and bounds in the face of competition and constant innovation. The flow of the paper is arranged as follows:

(a) Nature and object of the Code

(b) Key players in the insolvency resolution process viz.
    (i) The Corporate Debtor (CD)
    (ii) Administration of the CIRP by the
        - the committee of creditors (CoC); and
        - Resolution Professional (RP)

(c) The Adjudicating Authority (AA)

(d) Other vital aspects in a resolution process
    (i) Role of Interim Finance
    (ii) Solving the Valuation Jigsaw- Importance of valuation in a resolution

(e) The Way Forward
    (i) Increasing the number participants in the stressed debt market and establishing a secondary market for stressed debt instruments.
    (ii) Recent innovative resolutions

(f) Concluding thoughts

NATURE AND OBJECT OF THE CODE

The primary objective of the Code is to resolve insolvency of the CD as a *'going concern'* as against liquidation. The Code, in its current form, is predominantly a *'Creditor-in-control'*[2] driven resolution process, wherein as soon as the CIRP is initiated, the board of the CD is suspended and all powers of the management are taken over by the CoC and the RP Consequently, in majority of the cases, it has been witnessed that the operations/ business of the CD, often comes to a grinding halt or is slowed down considerably, thus adversely affecting the cash flow generation ability of the business. It is therefore imperative that not only does the CD entity needs to be rescued, but also the continuity of the CD's business needs to be ensured, only then the 'Going Concern' objective of the Code can be achieved in the true sense.

This is where the *'Debtor-in-possession'* kind of bankruptcy resolution is much needed, where the promotors are allowed to continue running the CD as a going concern. The process is well enshrined in the Chapter 11 of the US Bankruptcy Code. This allows the CD to recast their debt, while continuing to run their business and submit a restructuring plan in the best interests of all the creditors. The model assumes greater significance in the wake of recent shocks to the global economy caused by COVID-19 pandemic, volatility in commodity prices including crude oil and frequent geo-political crises across the world. The underlying principle being, that the existing promoter and its management may possibly be most competent entities to run the business to maximise cash flows of the CD in comparison to the CoC. Since they might have withstood similar shocks to their business in the past too.

So which model is more suited to resolve insolvencies in the Indian context?

The answer to this question is perhaps a hybrid model, that provides various alternatives of resolution, depending upon the nature or perhaps the cause of insolvency. For instance, in the case of MSME, a pre-pack resolution mechanism has been recently introduced in the Code. Since the insolvency resolution process is initiated much before the actual default, the adverse impact to the business can be minimised. The other reason for a pre-pack resolution for MSME can perhaps be traced to the scale of operations and the size of MSMEs which is much smaller in comparison to large CDs and hence may not require an elaborate CIRP. MSMEs, the pre- pack resolution is more suitable. This pre-pack is similar to the 'debtor-in-possession' resolution mechanism.

While, in case of large corporate debtors where the reason for distress/ insolvency is the incompetence or the fraudulent actions of the promoters, the current form of 'creditor-in-control' model of the Code becomes a necessity, a distinction must be drawn for corporate entities facing a genuine business failure. Perhaps for such corporate entities, cues may be taken from the 'debtor-in- possession' resolution as per the Chapter 11 of the US Bankruptcy Code or even with the administration in UK, where an administrator is appointed to manage the debtor but with a lesser degree of creditor control.

As debt markets mature and creditor base is broadened a hybrid model of insolvency resolution viz. 'creditor-in-control' along with 'debtor-in-possession' may have to be adopted as the situation may require.

However, as the debt market matures further in India, with the broadening of creditor base beyond banks and growth of market for the distressed debt instruments, it would become imperative for the Code also, to expand its approach towards resolution, and deal with each insolvency in a more customised way.

KEY PLAYERS IN THE INSOLVENCY RESOLUTION PROCESS

The Corporate Debtor

The Code has definitely proved to be a deterrent for the chronically defaulting corporate promoters. The fear of losing their company has become real and thus certain degree of responsiveness is surely visible. While genuine business failure is an acceptable situation for all entrepreneurs across the globe. But for errant and defaulting promoters, Code has ensured to make a statement that payments to lenders is not an ‘option’ available with such promoters but an ‘obligation’ that ought to be fulfilled. To that end one may look into the following:

Prevention of default and early detection of stress:

As soon as it is ascertained that a default has happened, it is important to initiate the insolvency proceedings immediately. The more the delay the more destruction in the value of assets of the CD and lesser the realisable value to the lenders.

In fact, taking a step back, what needs to be done, is to put in place a robust mechanism for early warning of stress incorporates continuously monitor the situation and take corrective action as and when warranted. Signs of deteriorating debt equity ratio, irregular servicing of interest, default in payment of essential supplies, losing a large customer, frequent change in the board of directors, defaults in other group entities, etc. may be some early indicators which should draw one’s attention towards an emerging stress.

A database comprising of banking as well as outside banking credit information, when analysed with sophisticated analytical tools including Artificial Intelligence may prove to be a gamechanger in early detection of stress.

Data relating to credit as well as ancillary data when combined with sophisticated tools of analytics, including the use of Artificial Intelligence to predict the credit behavior of loan accounts would prove to be quite useful in early detection of financial stress and prevention of default.

The Code deals with Information Utilities to store facts about lenders as well as terms of lending in electronic databases to be used by the AA for ascertaining ‘default’. Currently, the IBBI[3] has empanelled two vendors, namely, NeSL and Mjunction, for providing platforms for distressed assets, with four elements viz.- (a) Market for Interim Finance, (b) Virtual Data Room, (c) Invitation and Evaluation of Resolution Plans, and (d) Auctions for Liquidation Assets. As participation increases, the platforms may prove to be gamechangers, providing cost efficient resolutions.

The concept is required to be further expanded and integrated to create a central database storing records of secured assets, whether registered under the Companies Act, 2013 or the Registration Act, 1908 or even the Motor Vehicles Act, 1988. The object should be to capture the additional credit information outside the banking system, so that the same may be available for analysis, to facilitate efficient credit decision making by lender institutions. The database and the associated analytics may serve as an early warning to credit institutions, not only at the time of loan appraisal but also towards loan monitoring thus avoiding or at least detecting insolvency at an early stage so that the resolution may happen even before the asset becomes stressed.

Administration of the CIRP

The administration during the CIRP period is entrusted upon the CoC and the Resolution Professional (RP) and a clear role of their roles and responsibilities is essential to any successful resolution.

Committee of creditors

During the CIRP process, the board of directors of the CD is suspended and a fiduciary responsibility is placed upon the CoC to take all the decisions. In fact, the recent judicial precedents have placed a high value to the 'commercial wisdom' of the CoC, and the courts generally are not too keen on interfering with the decisions of the CoC.

Goal Alignment: It's the CoC's obligation to align their interests along with all the other stakeholders. While it is understandable that the lender, while sitting at the CoC table, is already grappling with a non- performing asset and staring at a haircut in realisation, may be eager to just say yes to any resolution proposal put forth. It is at this juncture that the CoC needs to be patient and market the CD to realise maximum value of its assets.

Timely and effective decision making: Much of the value of the underlying assets of the corporate debtor is lost with time efflux as a result either the value realisation is too low or the CD moves into a possible liquidation. As per IBBI's September 2021 newsletter, 73% of the CIRPs went on for more than 270 days against the stipulated 330 days as per IBC. Its, therefore, important that only senior and duly authorised personnel are represented at the CoC.

Code of conduct for CoC

The members of the CoC enjoy enormous powers under the Code and even several judicial pronouncements have established that the courts would generally not question the 'commercial wisdom' of the CoC. Therefore, given the stature of the CoC in the entire resolution process it is imperative that the CoC should be made more accountable and thus bring about transparency to the resolution process under the Code. The CoC, at present, functions in an unregulated environment.

In recent times, there have been instances where the actions of the CoC have been in question, as being detrimental to the objects of the Code itself. E.g., in the recent case of Siva Industries Holding, the CoC accepted a one-time settlement from its erstwhile promoter, who had offered a mere 6.5% of the total debt, and thereafter filed a withdrawal application with the AA. Similarly, in the matter of resolution of Videocon Industries the AA expressed surprise to know that the lenders were ready to take a 96% haircut and that the resolution applicant's offer was so close to the liquidation value, which is supposed to be confidential.

With that background, the IBBI has recently come up with two discussion papers (one for resolution and other for liquidation) to seek stakeholders' views on its prescription of the does and don'ts for the CoC. Among other issues, the IBBI paper suggests that CoC members maintain integrity and ensure decisions are made without any bias, favour, fear, coercion, undue influence or conflict of interest. They must not misrepresent facts or influence the CoC's decision to benefit related parties. They have to disclose conflict of interests and they won't acquire assets of the CD even indirectly nor will they permit their relatives to do so without disclosing it to stakeholders.

This is a much needed and welcome step taken by the IBBI and should form the basis of a model code of conduct for the CoC going forward.

Protection of Minority Creditors' Interest/ Democracy in CoC*:* In many cases specially the MSMEs and sometimes in large corporates too, it is seen that decision making in the CoC is tilted towards the lender with the largest exposure/ security interest in the corporate debtor. This needs to be balanced out to ensure that all stakeholders, as opposed to just one or just a few, derive value out of resolution in a just and fair way. An amendment that which has the spirit of provisions of 'Oppression and Mismanagement' under the Company Act, 2013 is definitely required for the purpose.

The success of any resolution plan would largely depend upon whether it is fair and equitable to all stakeholders, including the impaired class of creditors. Otherwise, there is a high risk of the plan getting defeated or held up by dissenting creditors.

While the US bankruptcy laws provide the *'cram down'*[4] of entire classes of creditors, in the event the bankruptcy court is of the view that the resolution plan is fair and equitable and does not discriminate unfairly vis-à-vis the dissenting class of creditors. However, in the UK, a 'cram down' of secured or senior debtors is not possible in company voluntary arrangements and administration. Only creditors, including secured creditors, within the same class can be crammed down using a scheme of arrangement.

In contrast the situation in in India is a little different. The Code does not require the RP, the CoC or the NCLT to consider the interests of dissenting creditors (provided the plan is approved by 66% majority of financial lenders) in proposing and approving a resolution plan. In essence, a cram down of not only the dissenting financial creditors but also of an entire class of creditors viz. the operational creditors are possible under the Code.

The operational creditors mostly comprise of MSMEs, which are the backbone of the country's economy. Adequate representation in the resolution process would provide them a 'fair and equitable' treatment. Parallels may be drawn from the US and UK insolvency laws and the treatment of impaired creditors.

However, recent judicial pronouncement and subsequent amendments in the Code have thrown some light upon the treatment of various classes of creditors including operational creditors. In Essar Steel, the Hon'ble Supreme Court upheld the principle of equality amongst 'similarly placed creditors'. The Code also now expressly provides for minimum payment of liquidation value to operational creditors. Though this may not be enough, given that most of the operational creditors are suppliers of raw material or intermediaries or service providers to the corporate debtors in question. In fact, MSMEs are the backbone of Indian economy and continued blows to their claims in insolvency resolution may affect the Indian economy in the longer run.

Therefore, a more balanced approach is required to achieve the objective of 'fair and equitable' treatment of all classes of creditors. The spirit is similar to that of the protection of minority shareholders from oppression and mismanagement under the Companies Act, 2013. To that end, some cues may be taken from the US and UK insolvency laws, wherein the 'impaired' classes of creditors have the right to not only vote but also reject any restructuring proposal that may alter their rights. For instance, a separate committee of unsecured creditors is formed during the insolvency resolution process to ensure due representation of interests of such unsecured creditors, providing them wide powers of participation in the resolution plan and even to recommend liquidation, if it is in the best interest under the Chapter 7 of the US Bankruptcy Code.

Further, the conformation of the restructuring plan by the bankruptcy court generally requires the acceptance of such plan by impaired classes of claims and interests viz. by creditors holding at least two-thirds in amount and more than 50% of the allowed claims (in number) of the allowed claims and holders of at least two-thirds in amount of the allowed interest. Similarly, in the UK, the schemes of arrangement require the approval of at least 50% in number, representing at least 75% in value, of each class of creditors (UK Companies Act, 2006).

Therefore, as discussed earlier, although option of 'cram down' is available in both jurisdictions but the risks involved, potential delays as also the tenability of such actions in the bankruptcy court usually encourage the creditors to avoid such an extreme measure to get the resolution plan approved and instead bring about a consensus for plan approval.

The Resolution Professional

If the CoC's is like the board of directors of the CD during the CIRP, then the RP's is like the CEO of the entity, whose role is administrative in nature viz. to work according to the directions of the CoC. Nevertheless, the role requires demonstration of high degree of management efficiency as also acknowledgement of the fiduciary responsibility upon the incumbent. To that end, constant monitoring of the actions taken by RP by the regulator (much like the concurrent audit in banks), continuous upgradation of the skill set of the RPs and ensuring that the assignments are given to all the qualified RPs are some of the ways to increase the effectiveness of RPs role.

THE ADJUDICATING AUTHORITY

One of the most critical components in the resolution process is judiciary. Since the inception of IBC, various courts in India have been proactively interpreting the IBC, setting landmark precedents, thus successfully helping IBC evolve.

However, it's said that justice delayed is justice denied. Consequently, the overpouring insolvency matters are clogging our legal infrastructure causing delays in timely disposal, leading to not only a substantial value erosion of the assets of the CD but also making it unviable for the potential suitors.

Therefore, what may be deliberated, is the constitution of a separate nodal body (perhaps a quasi-judicial) which can approve/ disapprove routine matters, while the NCLTs may concentrate on important 'questions of law' arising in a matter. This would also reduce the unwarranted litigations initiated to delay the resolution.

One can also use the electronic case management system to reduce the effective number of court appearances/ hearings, as followed by many of the foreign courts. In the US bankruptcy courts, as soon as a bankruptcy is filed, the court appoints a qualified Trustee who completes the bankruptcy process, with the applicant never even having to face the judge till the completion of the matter.

Still more NCLT benches, than we have at present, are required to not only dispose the insolvency matters timely, but also instill confidence in the potential resolution applicants about the certainty and finality of the process.

OTHER VITAL ASPECTS IN THE RESOLUTION PROCESS

Role of Interim Finance

The Code permits raising of interim finance by the RP with the approval of the CoC. For the said purpose, the RP may provide security of the unencumbered assets of the CD or even the encumbered assets with the requisite approvals of the CoC. This is in contrast to the insolvency provision of the US, where bankruptcy court can virtually impose interim finance arrangements on the existing creditor, albeit with certain safeguards.

Interim finance is virtually the lifeline of any CD during a CIRP, especially when the cash flows of the CD are dwindling or have completely dried up. Timely infusion of interim finance into the CD is necessary to ensure that it stays afloat during the CIRP, so that not only it may be resolved as a 'going concern' but also the value of the asset is preserved, which in turn would maximise the value for the stakeholders upon resolution. Therefore, the members of the CoC need to make timely decisions in sourcing and approving the terms on which the interim finance is available even if it means ceding the priority charge to the provider of interim finance.

The interim finance has been accorded super-priority payment status under the Code. This coupled with the fact that such interim finance is generally offered at high interest rates for a short duration of exposure, has been drawing a lot of interest from potential providers of interim finance.

Solving the Valuation Jigsaw- Importance of valuation

Any efficiently running corporate may increase its profits by either reducing its costs or increasing its revenue or both. Similarly, when a CD is required to be resolved through CIRP, all efforts need to be put in to fetch the maximum asset value and simultaneously keep the CIRP costs at minimum.

Valuation and Benchmarking for evaluation of the Bids

The Code define the liquidation value (LV) as '*the estimated realisable value of assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date'*. In other words, the LV is the value that would be realised from an asset in a 'hypothetical liquidation scenario', which is virtually similar to the concept of 'vertical comparison' under Chapter 11 of the US Bankruptcy Code.

At present, all bids (resolution plans) received, are evaluated by comparing them with LV as the basis for selecting the successful bid. The question then arises that if the asset is to be resolved as a 'going concern' then why the LV is required to be used for benchmarking?

For the resolution of stressed assets as a 'going concern', the use of 'fair value', 'market value', 'realisable value' or even 'distress value' may reflect better benchmarks in comparison to 'Liquidation Value'.

The issue assumes greater importance, when the asset in question is an operating asset that is generating cash. As a result, benchmarking such operating assets against the LV may lead to far lesser valuation in the resolution than it is actually worth. Therefore, it would be pertinent to use 'Fair Value' or 'Realisable Value' or at worst 'Distress Value' of the asset as a more appropriate benchmark for evaluation, being also consistent with the nature of the underlying asset itself. The LV ought to be used for comparison of bids only in an actual liquidation scenario. The recent resolution of Videocon Industries in which the lenders took a 96% haircut (the same has been stayed by the Adjudicating Authority recently) or Amtek Auto with almost 79.3% haircut are a case in point.

Related to valuation is another aspect that requires attention, that being the method or procedure of valuation. The Code at present does not prescribe any particular method or procedure for valuation of the assets of the CD. The absence of any 'standard' method of valuation, under the Code may lead to some unwarranted implications like incorrect valuation, whether intentional or otherwise, lapse of diligence and breach of care, to name a few as also observed during the resolution of some recent cases.

It seems that the regulator too is cognizant of the fact that not only standardisation of valuation methodology, but also greater accountability of the valuers is required for successful resolutions. Perhaps for this reason the IBBI has proposed The Draft Valuers Bill, 2020. This is a welcome step. It is expected that this would not only benefit the valuation profession but also protect the interests of the users by providing redressal mechanism, ensure standard quality of service and mandatory compliance with setting out of valuation standards.

Budget for Expenses

A budget needs to be chalked out at the beginning of the CIRP capturing the expected CIRP costs, associated during the period and all variances need to be properly analysed with responsibilities fixed for any budget spill overs.

WAY FORWARD

Deeper Market with more participants and establishment of a secondary market for stressed loans

When compared to the more developed economies, the debt market in India is nascent, more so the stressed debt market which is virtually new. The banks are already grappling with the higher provisioning norms for the stressed assets, thus their ability to provide further credit is severely constrained, causing a shortage of risk capital required to resolve the quantum of stressed assets in the country. This can be dealt with a two-pronged approach- increase in the number of participants in the debt market and developing a robust secondary market for such debt securities.

Traditionally the banks in India and subsequently, shadow banks like NBFCs / MFs / ARCs etc. are the only active players in India's debt market. The banks were allowed to sell their stressed loans only to ARCs.

However, recently the Securities and Exchange Board of India has introduced Special Situation Funds (SSFs)[5] as a distinct Category I Alternative Investment Funds (AIFs), who would be allowed to participate in the secondary market of loans to corporates that have defaulted their debt obligations. While AIFs were active players in the equity market, their role in the distressed debt market was minimal. This is definitely a step in the right direction. The next step or corollary to the introduction of SSFs, in the defaulted debt would be allowing the SSFs to participate in the secondary market of corporate debt before default.

The foreign markets have already institutionalised the loan market and non-banking entities like pension funds, hedge funds, insurance companies as well as private equity funds are active participants in such secondary loan market. As per the RBI's report of the Task Force on secondary market for corporate loans, chaired by Shri T. N. Manoharan,[6] some of the benefits that a well-developed corporate bond market may provide specially for stressed assets are:

a. ***Capital Optimisation***: Banks can unlock their capital by down selling their exposures towards certain identified borrowers which may help them in taking advantage of new lending opportunities. As such, the secondary market can serve as an effective tool to actively manage their loan portfolios to comply with regulatory capital requirements on an ongoing basis.

b. ***Opportunities in Stressed Entities***: An investor may participate in the loan obligation of a stressed entity through the secondary market to influence the borrower's insolvency or resolution process based on its assessment of the probability of reviving the company and make profit from any upside value of the business. In some cases, the investor may also take a view that the recovery through breakup value of assets or via insolvency will be sufficient to give a decent return on the original investment.

c. ***Improving origination standards***: A robust secondary market would provide with early warning signals regarding riskiness of the debt being held by the banks which would incentivise improving the underwriting and origination standards.

d. ***Widening of lenders base***: It enables the larger borrowers to widen their lenders base It helps the borrowers to have better access to market participants with different risk appetites by multiple trenching of loans basis security coverage, maturity, etc.

e. ***Liquidity Management***: The secondary market can help banks in managing their asset liability mismatches by facilitating liquidation of a long-term exposure and deployment of those funds to meet unforeseen obligations.

f. ***Price Discovery Mechanism***: A well-developed secondary loan market could result in an efficient price discovery mechanism as the loan gets churned multiple times during its lifetime thereby reflecting the prevailing market perceived price. This would in turn facilitate appropriate pricing of future loan assets of same borrower/sector.

While scheduled commercial banks are expected to actively participate in the proposed secondary market, other players including RBI registered NBFCs, ARCs (for stressed assets), Public Financial Institutions, Insurance Companies registered with IRDAI, Pension Funds registered with PFRDA, Mutual Funds, AIFs and FPIs registered with SEBI may also be permitted to participate in the market to provide liquidity and ensure orderly development of the market.

However, there is a fair amount of legal as well as regulatory framework required to be established to ensure a robust secondary market for stressed loans.

Recent Innovative Resolutions

The Code provides high degree of flexibility towards resolving stressed assets. The recent amendments to the Code provide mergers and acquisitions, divestments, spin-off and other restructuring mechanisms to resolve the asset. This has also opened new avenues of resolution, as against a simple auction (sale to the highest bidder) based resolution process. Structuring a stressed asset appropriately also unlocks the value of other assets that may have been imbedded in the CD.

Recently, the resolution of IL&FS, which although was commenced under the restructuring provisions of the Companies Act, 2013, demonstrated that higher realisations could be achieved in case the resolution is done innovatively, keeping in mind the nature of asset, its marketability and the risk appetite of investors who would be willing to take an exposure in such assets. The IL&FS resolution involved not only the restructuring of loans but also setting up of Infrastructure Investment Trusts (InvITs) for its road assets. This has also paved the path for other infrastructure, real estate entities in stress, for a successful resolution that can be achieved by efficient utilisation of platforms like the Real Estate Investment Trust and InvITs ensuring higher realisations in comparison to the vanilla auction process.

CONCLUSION

What IBC has been able to achieve, towards resolution of stressed assets in India, in such a short period of its existence, is commendable. Equally noteworthy is the legislative intent with which a slew of amendments in the Code and other laws have ensured that the Code is agile to the dynamic and evolving economic landscape of India.

The economic uncertainty, outlook for monetary and fiscal policy, and ongoing potential impact of the COVID-19 pandemic are likely to have enormous consequences on corporate results, outlook and opportunities in the years ahead. As we emerge from the pandemic lockdown, companies are being forced to think outside the box, and investors and regulators too should do the same. Stress in the entities is natural as part of a growing economy, what is important is how quickly it is detected and how efficiently it is resolved.

[1] IBBI Quarterly Newsletter, July - September, 2021.
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[4] RBI publications (2017), Insolvency and Bankruptcy Code and Bank Recapitalisation, December.
[5] Datta P. (2022), "Why Special Situation Funds are Necessary", *The Indian Express*, 19 March.
[6] RBI's Report of the Task Force on the Development of Secondary Market for Corporate Loans, September, 2019.

ABOUT THE AUTHORS

Ms. Aakriti Anurag Tewari
Ms. Aakriti Anurag Tewari is a third year undergraduate student at Jindal Global Law School, completing the 5-year BA LLB program. Her interests are broadly centered around M&A, Private Equity, Technology Law, and ADR. She is a vocal proponent of mediation as one of the most effective methods to resolve niche disputes, firmly believing in the importance of alternate forms of dispute resolution in a post-COVID world.

Ms. Ajanta Gupta
Ms. Ajanta Gupta is currently a Research Associate in IBBI since 2018. She is a Chartered Accountant and received her undergraduate degree in Law from Faculty of Law, University of Delhi and LLM from O.P. Jindal Global University. She has cleared Limited Insolvency Exam in 2017 and Registered Valuer Exam in Securities and Financial Assets class in 2020. She has obtained her certificate in Forensic Accounting and Fraud Detection from ICAI, completed her training in commercial Mediation from IICA in collaboration with High Court of Delhi and registered as an Independent Director with IICA. She is a member of INSOL International.

Mr. Ritesh Kavdia
Mr. Ritesh Kavdia is working as Executive Director in IBBI since 1st February 2018. Earlier, he had been serving IBBI as Chief General Manager since December 2016. He is an Indian Telecommunication Service officer from the batch of 1996. He completed his Bachelor of Engineering degree from Regional Engineering College (Now, NIT), Jaipur, and has completed Executive Master of Public Administration from Syracuse University, Syracuse, USA. He also has concurrent certificates of Advance Study in Leadership in International and Non-Governmental Organisations, and E-Government Management & Leadership from Syracuse University, Syracuse, USA. He has 24 years of experience in the areas of Telecommunication, Management and Public Policy. Before joining IBBI, he had served at the Ministry of Defence, Government of India as Director.

Mr. Anshul Agrawal
Mr. Anshul Agrawal is a Manager at IBBI and is currently posted in the legal affairs division. Prior to joining IBBI, he worked in the private equity and M&A team of Veritas Legal, Mumbai. He holds an LL.M in corporate and commercial laws from NALSAR University, Hyderabad.

Mr. Akash Chandra Jauhari
Mr. Akash Chandra Jauhari is a Senior Resident Fellow at Vidhi Center for Legal Policy working in the area of Corporate Law and Financial Regulation, including insolvency and bankruptcy laws. He has also practiced law in the fields of public and private law. In addition, Akash has also contributed to commentaries on insolvency and bankruptcy laws and anti-money laundering laws.

Ms. Raghavi R.
Ms. Raghavi R. is a final year student pursuing B.Com. LL.B. (Hons.) at Tamil Nadu National Law University. She has also completed her Bachelors in Fine Arts in Bharatanatyam (Correspondence). She is interested in learning about Insolvency Laws and has worked as a student contributor in the 2nd edition of the Guide to the IBC published by Wadhwa Law Chambers in April 2021.

Mr. Bahram N. Vakil
Mr. Bahram N. Vakil is a Co-Founder and Senior Partner of AZB & Partners and is renowned for his

restructuring, bankruptcy, and infrastructure / project finance experience. He has served on various high–level government committees on financial reform, FDI, and securities market reform. Amongst these, he was appointed as a key member of the Dr. T K Viswanathan Bankruptcy Law Reforms Committee, constituted by the Indian Ministry of Finance, to draft the IBC. He is also a member of the (a) Insolvency Law Amendment Committee, constituted by the MCA to recommend amendments to the IBC; (b) International Insolvency Institute (III), a non–profit, limited membership organisation set up to promote international cooperation / coordination in the insolvency field (the first lawyer to be invited to the III); and (c) Member of the Task Force on the Development of Secondary Market for Corporate Loans set up by the RBI in 2019.

Mr. Suharsh Sinha

Mr. Suharsh Sinha is a Partner in AZB & Partners and specialises in restructuring & insolvency, banking & finance and structured finance & securitisation. He was appointed as a consultant to the Bankruptcy Law Reform Committee and IBBI, which was instrumental in drafting the policy and legislation behind the IBC. Along with being an attorney, he is a qualified CFA. He holds an MS in Law and Finance from the University of Oxford and an LL.M. and Wharton Business and Law Diploma from the University of Pennsylvania Law School and the Wharton Business School. He is licensed as a solicitor in England (Law Society of England & Wales) and is also qualified to practice law in the United States, being a member of the New York State Bar.

Ms. Saloni Thakkar

Ms. Saloni Thakkar is a Senior Associate in AZB's restructuring and insolvency group. Her practice areas include structured finance, restructuring and insolvency and banking and finance. Over the last few years, she has actively supported several significant restructuring and insolvency transactions of the firm. She has been a key member of the teams advising certain creditors and a resolution applicant in the corporate insolvency resolution of the Reliance group companies, the Administrators in the corporate insolvency resolution of Dewan Housing and Srei entities, the Resolution Professional in the corporate insolvency resolution of the Adhunik group companies.

Mr. Eshan Jaipuriar

Mr. Eshan Jaipuriar is a stressed asset professional and a certified mediator with demonstrated experience in Insolvency & SARFAESI advisory. He is currently pursuing Graduate Insolvency Programme at IICA, under the aegis of the Ministry of Corporate Affairs and is passionate about insolvency & recovery laws.

Ms. Rishika Raj

Ms. Rishika Raj is a stressed assets professional and a certified mediator. She is currently working in the domain of stressed assets and recovery laws. She was the part of first batch of Graduate Insolvency Programme at IICA, under the aegis of the Ministry of Corporate Affairs and is a member of INSOL International.

Mr. L Viswanathan

Mr. L Viswanathan is a Partner at Cyril Amarchand Mangaldas. He is the Chair of Finance, Projects & Insolvency Practice at the Firm. He has rich experience in Restructuring and Insolvency, Project Finance and Banking, and Infrastructure and Energy Projects. He has been involved in several landmark cases including the first insolvency resolution process in the case of *Innoventive Industries Limited* initiated under the Code, *Swiss Ribbons v. Union of India* in which the constitutionality of the IBC was upheld by the Supreme Court, resolution of *Essar Steel*, resolution of the *IL&FS* group, and resolution of *DHFL*.

Mr. Animesh Bisht

Mr. Animesh Bisht is a Partner at Cyril Amarchand Mangaldas. He focuses on corporate insolvency, banking, finance and regulatory litigation. He has been involved in various landmark litigations in the insolvency and bankruptcy practice including, the first insolvency resolution process in the case of *Innoventive Industries Limited* initiated under the Code, resolution of *Essar Steel*, resolution process of *Videocon Group Companies*, resolution of *DHFL*. He regularly advises and represents clients before various forums including the NCLT, NCLAT, various High Courts and the Supreme Court.

Mr. Karan Sangani

Mr. Karan Sangani is an Associate with the Dispute Resolution practice of Cyril Amarchand Mangaldas and has contributed to the research paper. He also contributes to the monthly column titled 'Insolvency Law in Review' on Live Law.

Ms. Laura Coordes

Ms. Laura Coordes is an Associate Professor at Arizona State University's Sandra Day O'Connor College of Law, where her research focuses on bankruptcy and financial distress, as well as commercial law, large corporate reorganisations, and local government finance and policy. She received her J.D. with honors from the University of Chicago Law School. She completed a legal fellowship at the Student Press Law Center after receiving her degree. Before coming to the College of Law, she practiced in the Business, Finance and Restructuring Department at Weil, Gotshal & Manges in New York.

Ms. Misha

Ms. Misha is a Partner at Shardul Amarchand Mangaldas & Co. with over 15 years of experience in dispute resolution and Insolvency and Bankruptcy practice. She has also been involved in advisory work especially in relation to Insolvency and Bankruptcy Laws, General Corporate Laws and Economic Offences.

Ms. Shreya Prakash

Ms. Shreya Prakash is a Senior Associate in the Insolvency and Bankruptcy team at Shardul Amarchand Mangaldas & Co. She is an alumna of NLSIU, Bangalore and University of Oxford and has made significant contributions to the field by providing research and drafting support to the Working Group on Group Insolvency and the Insolvency Law Committee.

Ms. Kritika Poddar

Ms. Kritika Poddar is an IBC Research Fellow at Shardul Amarchand Mangaldas & Co. Kritika is a graduate of GNLU, Gandhinagar and has experience in insolvency litigation.

Dr. Neeti Shikha

Dr. Neeti Shikha is Associate Dean, Indian School of Public Policy, New Delhi. She had also worked as Head, Centre for Insolvency and Bankruptcy, IICA, a think tank under the Ministry of Corporate Affairs. She holds PhD from NLU Jodhpur and LLM from University College London, UK. She is recipient of prestigious Hague Scholarship and has pursued course in private international law at the Hague Academy, Netherlands. She has held academic positions at various law and business schools in India and Singapore.

Ms. Shambhavi Singh

Ms. Shambhavi Singh is a Corporate Lawyer in the field of IBC, Companies Act, 2013 and various labour laws along with specialisation in Indian defence acquisition. She has developed various POSH policies for different corporate entities and trusts. She is currently pursuing her Masters in Policy, Design and Management from the Indian School of Public Policy. Her interests include working in the law and public policy sector, national defence domain and the health sector.

Mr. Rishabh Ahuja

Mr. Rishabh Ahuja is a scholar at the Indian School of Public Policy and is currently the Executive Editor of the Policy Review of the institute. He graduated with a B.A. Honours (Humanities and Social Sciences) from the University of Delhi. With a background in interdisciplinary studies, he focuses on Politics and Behavioural Economics. In addition, he was the Chief Editor of the Public Policy vertical at the Youth Policy Review, an online academic blog.

Mr. Nipun Singhvi

Mr. Nipun Singhvi is a practising Advocate, FCA, CS, LLB, LLM (Corp. Laws), Certified Forensic and IFRS Bank Auditor. He is a qualified Independent Director (Ministry of Corporate Affairs) and completed Executive Program on M&A (IIM-Ahmedabad). He has been Member of World Bank Insolvency group on 'Train the Trainers' jointly with IBBI, and IPA of all three institutes ICAI, ICSI & ICMAI. He has been part of various Committees of ICAI on Corporate Laws, Bank Audit, Accounting Standards and a contributor to WIRC Reference Manual on Insolvency Laws.

Ms. Pragati Tiwari

Ms. Pragati Tiwari is a practicing Advocate at Gujarat High Court, NCLT Ahmedabad, NCLAT and various other High Courts and Tribunals. She has been dealing with cases related to IBC and Companies Act representing Resolution Professionals, Resolution Applicants, Suspended Board and Committee of Creditors.

Ms. Pooja Singla

Ms. Pooja Singla is working as Manager in the Research Division at IBBI. She is a Chartered Accountant, having completed her graduation from Delhi University. She has previously worked as an Executive Officer with Export Credit Guarantee Corporation, Mumbai.

Mr. Vinay Pandey

Mr. Vinay Pandey is working as Manager in the Inspection, Investigation and Complaints relating to IP/IPEs Division, IBBI. He is a Lawyer, having completed his LL.B from Campus Law Centre, University of Delhi. He has previously worked as an Assistant Manager in Oriental Bank of Commerce, Mumbai and as an Auditor in Principal Controller of Defence Accounts, Chandigarh.

Mr. Pratik Datta

Mr. Pratik Datta is a Senior Research Fellow at Shardul Amarchand Mangaldas & Co. He was previously with the Supreme Court of India and then the NIPFP, a think tank of the Indian Finance Ministry. He completed his B.A., LL.B. (Hons) from the West Bengal National University of Juridical Sciences in 2010 and MSc in Law and Finance from University of Oxford in 2018 as a Chevening Weidenfeld Hoffmann scholar. He has advised the Indian Government on various momentous financial reforms including drafting of the IBC.

Ms. Priya Misra

Ms. Priya Misra is an Assistant Professor of Law and a Legal Consultant in specialised areas of Business Laws. She has taught at NLSIU, Bengaluru, University of Petroleum and Energy Studies, Dehradun and at RMLNL, Lucknow. She is pursuing her PhD from NLSIU in the area of Cross-border Corporate

Insolvency Law. Her current areas of interest include Corporate Insolvency Law, Corporate Governance and Corporate Social Responsibility.

Prof. Rajendra Prasad Gunputh

Prof. Rajendra Prasad Gunputh is the Dean of the Faculty of Law and Management, with a Personal Chair in International Comparative Law. He supervises MPhil/PhD students (22 students), has contributed to two treaties on Civil Law and Criminal Law, 10 manuals for the UoM, has authored 10 manuals on Public International Law and International Humanitarian Law and SDGs, has contributed to more than 150 articles in regional and international journals with more than 100 conference proceedings worldwide, and is a blind peer reviewer for various international journals. He organises regular webinars, workshops and international conferences on Law, moot competitions and is also a member of a number of national committees.

Mr. Sumant Batra

Mr. Sumant Batra is an Insolvency Lawyer of international repute, social commentator and thought leader. He is the Past President of INSOL International, the youngest and the only Asian to have achieved that fete. As senior international insolvency consultant to the World Bank Group, IMF, OECD and other developmental institutions, he has worked extensively on policy matters in Africa, Eastern Europe, Middle East and South Asia. Rated as India's No. 1 Insolvency Lawyer by Legal 500 for many consecutive years, he is recognised by Global Restructuring Review as one of the top 30 restructuring lawyers in the world. His contributions in the development of Indian insolvency law and industry are well recognised. The only Indian Lawyer with over 25 years of experience in insolvency at global and Indian level, he is the President of SIPI – the think tank of the insolvency industry. A cultural champion, he is the founder and architect of a number of innovative creative projects to promote the Indian heritage, culture, art and literature. He is the author of the bestsellers – *Corporate Insolvency – Law & Practice; An Actor's Actor: An Authorized Biography of Sanjeev Kumar;* and *The Indians*.

Mr. Vijaykumar V. Iyer

Mr. Vijaykumar V. Iyer is a registered Insolvency Professional. He is also a fellow member of the ICAI and an associate member of the ICMAI. He has 25+ years of professional experience and has worked on over 400 domestic and cross-border M&A transactions. He is currently a Partner in Deloitte India Insolvency Professionals LLP and has handled several cases under the IBC framework including *Binani Cement Ltd., Bhushan Steel Ltd., SPS Steels Rolling Mills Ltd., Aircel Ltd., Aircel Cellular Ltd., Dishnet Wireless Ltd.* and *Murli Industries Ltd*.

Mr. Abhishek Sood

Mr. Abhishek Sood has completed his B.Com (Hons) from University of Delhi, and holds a PGDM from IIM Bangalore. He has more than 11 years of experience which includes assignments in transaction advisory, business operations and corporate banking, including fund raising, loan sanctions and restructuring. He joined Deloitte in 2017 and has worked on several IBC cases in supporting the Resolution Professional including *Bhushan Steel Ltd.* and *Gwalior Bypass Project Limited*.

Mr. Shashwat Sharma

Mr. Shashwat Sharma is currently pursuing Graduate Insolvency Programme, a flagship programme of the IICA, Government of India. As part of the GIP curriculum, he is currently interning with Deloitte India, in their Financial Advisory- Restructuring Services. He has completed BA LLB (Hons.) from NMIMS Kirit P. Mehta, School of Law, Mumbai.

Ms. Vinita Singh and Ms. Jeeri Sanjana Reddy

Ms. Vinita Singh and Ms. Jeeri Sanjana Reddy are students of DSNLU, Visakhapatnam. They are majoring in B.A. LL.B. (Hons.) course. They have developed a keen interest in the areas of ADR and Insolvency and Bankruptcy Law, which has resulted in the inception of the idea of applying ADR within the insolvency regime. They strive to seek new experiences and delve deeper into the study of the various nuances of ADR and Insolvency regime.

Mr. Vishal J Dave

Mr. Vishal J. Dave is a practicing Advocate at Gujarat High Court and various High Courts, Tribunals and Supreme Court. He was appointed as the Assistant Government Pleader before High Court of Gujarat. He has handled and appeared in various Civil, Criminal, Corporate, Cyber and Tax litigation. He has also been involved and argued many Public Interest Litigations. He has also handled and argued litigation challenging constitutional validity such as merger of tribunals through Finance Act, 2017, National and State GST Appellate Tribunal, constitution of Authority of Advance ruling under GST Act, formation of RERA Appellate Tribunal, coram of NCLT etc. He is regular faculty and speaker at ICAI, ICSI, Nationalised Banks, CAG and author of various corporate and tax journals majorly in Taxmann, Corporate Professionals Today, TaxGuru, Taxscan, Live Law etc.

Mr. Mayur Jugtawat

Mr. Mayur Jugtawat is a practicing Advocate at Gujarat High Court and various High Courts and Tribunals. He has been dealing with cases related to the IBC on daily basis and handled more than 100 cases appearing for Resolution Professionals, Resolution Applicants, Suspended Board and Committee of Creditors.

Mr. Gabriel Eduardo Messina

Mr. Gabriel Eduardo Messina is a Lawyer, Law School, National University of Rosario; Economist, Exact Sciences and Statistics School, National University of Rosario; Especialist in Bussines Law, Law School, National University of Rosario; Corporate Law Professor, Law School, National University of Rosario; Economic Analisys of the Law Professor, Law School, National University of Rosario; Summer Institute in Law & Economics, University of Chicago Law School and a PhD candidate, Law School, National University of Rosario. He is a member of the American Law and Economic Association, Rosario Board of Trade, a Legal Manager in an Argentinian Stock broker and a member of the Rosario Bar association.

Mr. Kanwaljeet Singh

Mr. Kanwaljeet Singh is an Assistant Professor at Shri Aurobindo College of Commerce and Management, Ludhiana. His area of specialisation is Accounting and Finance and he has more than 12 years of teaching and research experience. He has published research papers in journals of international repute (Scopus and ABDC journals).

Dr. Rajdeep Singh

Dr. Rajdeep Singh holds a Ph.D. in Finance and has 7 years of academic and research experience. He is an alumnus of country's premier commerce college, Shri Ram College of Commerce, New Delhi and has done his M. Com Honors (Finance) from University Business School, Chandigarh. His major research areas are Behavioral Finance and Corporate Finance. He has published research papers in journals of international repute (Scopus and ABDC journals). He has worked with University of British Columbia, Canada on a research project funded by Shastri Indo-Canadian Institute. He has been awarded Professor Samiuddin Memorial Research Scholar Award by Indian Commerce Association for his research contribution.

Mr. Yadwinder Singh

Mr. Yadwinder Singh is working as an Assistant Manager in IBBI. Prior to joining IBBI, he was working with Agriculture Insurance Company of India Limited as an Administrative Officer (Finance). He has done M.com (Hons) in Finance from University Business School, Chandigarh. In addition to this, he is fellow member of Insurance Institute of India, Mumbai.

Ms. Medha Shekar

Ms. Medha Shekar is a Manager at the IBBI. She holds a Master's degree in Financial Economics from Gokhale Institute of Politics and Economics, Pune. She has previously worked as Assistant Executive Officer in Rajya Sabha Secretariat, Parliament of India.

Ms. Namrata Nair

Ms. Namrata Nair has served as a Research Associate at the IBBI. She holds a master's in development economics from the University of Sussex. She has previously worked as a teaching fellow under Dr. Arvind Subramanian and Dr. Nishant Chaddha at Ashoka University.

Mr. Sumit Banerjee

Mr. Sumit Banerjee is a doctoral student in the area of Finance & Accounting at IIM, Tiruchirappalli. Prior to this he has worked in the banking industry. His research interests lie in the area of accounting, auditing, earnings management, and corporate governance. He also writes newspaper columns on banking, accounting and finance in leading national dailies.

Dr. Swechha Chada

Dr. Swechha Chada is an Assistant Professor of Finance at Great Lakes Institute of Management, Chennai and a Ph.D. from IIM Tiruchirappalli. Her research interests lie in the area of corporate finance and corporate governance, particularly, ownership structure, governance and firm transparency. She has presented her research work at various conferences and doctoral consortiums. She has also written newspaper articles in Financial Express related to her research.

Ms. Priya Garg

Ms. Priya Garg is a faculty member at OP Jindal Global University. She is the Founding Trustee of 'The Corporate House'. She has been visiting faculty at NALSAR, GLC, NMIMS Mumbai and IIFT Delhi. She has completed her master's in law from Oxford (UK) and undergraduate degree in law from NLU Kolkata (University Gold Medallist with 12 Gold Medals). She has worked with Hon'ble Supreme Court and NCLT, Principal Bench.

Ms. Trusha Modi

Ms. Trusha Modi is a third-year law student at Jindal Global Law School and a Research Associate at 'The Corporate House'.

Ms. Balapragatha Moorthy

Ms. Balapragatha Moorthy is a penultimate year law student at Jindal Global Law School and a Research Associate at 'The Corporate House'.

Mr. Abhishek Halder

Mr. Abhishek Halder is a Ph.D. candidate in Finance and Accounting Area at IIM, Raipur. He holds a post-graduate diploma in banking and financial services from IMI Delhi and a bachelor's degree in civil engineering from NIT Warangal. He had served IBBI as a Research Associate Intern in 2018. He worked with IIM Ahmedabad as an Academic Associate in 2019-20. His managerial experiences are with Wipro and IDBI Federal Life Insurance. He has won national awards in business valuation and M&A. His research interests cover corporate finance, fixed income securities and quantitative finance.

Mr. Shashank Prakash Srivastav and Mr. Prateek Nahar

Mr. Shashank Prakash Srivastav and Mr. Prateek Nahar are Ph.D. candidates in Finance and Accounting Area at IIM, Raipur.

Dr. P. Vamsi Krishna

Dr. P. Vamsi Krishna is presently working as Business Management Consultant, Guntur. He has 14 Years of teaching experience at Malla Reddy University, Hyderabad and RVR & JC College of Engineering, Guntur, with one year industrial experience in Health Care Domain.

Dr. T. Sreenivas

Dr. T. Sreenivas is Professor in the Department of Business Management. Presently, he is Dean, Faculty of Commerce and Management in Yogi Vemana University, Kadapa. In his twenty seven years of academic career, he has many accomplishments in teaching, research and allied academic pursuits. He has to his credit a number of published books and articles on different aspects of management.

Mr. Prakhar Sharma

Mr. Prakhar Sharma is a qualified CA, CS and LL.B. He has a career spanning over 18 years in handling cross-border M&A, private equity, corporate restructuring / stressed asset resolution cutting across industry verticals. He also has successfully handled high value and domestic and international arbitrations and litigations. He is currently the Senior EVP - Corporate Legal at Kotak Mahindra Bank Ltd. and among other responsibilities, oversees the legal for the private equity as well as for the asset reconstruction businesses/ litigations and dispute resolutions for the bank. He is also a committee member of the Task Force for Insolvency and Bankruptcy Laws at the Confederation of Indian Industries.

भारतीय दिवाला और शोधन अक्षमता बोर्ड
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7th Floor, Mayur Bhawan, Shankar Market, Connaught Circus, New Delhi - 110001
www.ibbi.gov.in